POLLUTION CONTROL FINANCING FOR SMALL BUSINESSES (Part 2)

HEARINGS

BEFORE THE

SUBCOMMITTEE ON ENERGY, ENVIRONMENT, AND SAFETY ISSUES AFFECTING SMALL BUSINESS

OF THE

COMMITTEE ON SMALL BUSINESS HOUSE OF REPRESENTATIVES

NINETY-SEVENTH CONGRESS

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POLLUTION CONTROL FINANCING FOR SMALL BUSINESSES (PART 2)

WEDNESDAY, MARCH 10, 1982

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON ENERGY, ENVIRONMENT, AND
SAFETY ISSUES AFFECTING SMALL BUSINESS,
COMMITTEE ON SMALL BUSINESS,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9 a.m., in the Rayburn House Office Building, room 2359-A, Hon. Berkley Bedell (chairman of the subcommittee) presiding.

OPENING STATEMENT OF CHAIRMAN BEDELL

Mr. BEDELL. The Small Business Subcommittee on Energy, Environment, and Safety Issues Affecting Small Business will come to order.

We meet this morning to continue our oversight on the pollution control loan guarantee program administered by the Small Business Administration. There is great concern over the current status and the future of this program.

The pollution control loan guarantee program was established for the express purpose of assisting small businesses finance the cost of compliance with the Government's environmental regulations. Regardless of where each of us stands on the issue of environmental protection, there is no argument in this committee at least as to the merits of helping small businesses comply with the law.

Since there are a number of our subcommittee members who have other commitments that they have to meet, I am going to first yield to Mr. Eckart for an opening statement.

Dennis.

OPENING STATEMENT OF HON. DENNIS E. ECKART, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Mr. ECKHART. Thank you very much, Mr. Chairman.

First of all, I want to commend you for conducting these oversight hearings. I want to welcome witnesses from the Greater Cleveland area here today. Your testimony will be very valuable. I already have a copy of it. Unfortunately, I also have to be in the Education and Labor Committee to mark up our committee budget, a process we are all engaged in over the next several days.

Briefly, Mr. Chairman, as a Representative from the Cleveland area, I believe the efforts underway by the Reagan administration

to curtail the funding for the pollution control guarantee program constitutes a very real threat to the existence of some industries very important to my area.

Historically, there has been a very active electroplating metal finishing industry along the banks of the Cuyahoga River in Cleveland. It has long been one of the centers of this activity. I am pleased to see the bipartisan support and concern for the pollution control financing program, as evidenced by the statements of Hon. Silvio Conte, one of the ranking minority members of this committee.

The pollution control loan guarantee program has traditionally been a very well-run program, certainly no candidate for the waste, fraud, and abuse category. The program enables small business owners whose industrial activity happens to result in the creation of pollution to conform with our Federal antipollution laws. Without this assistance, some of these companies would either be forced out of business or their operations would continue to unnecessarily damage our environment.

For this reason, I am pleased by the representation here from the Greater Cleveland area to affirm once again the importance of this program to Greater Cleveland industry. The program in question, we were told in hearings last year, has never had a single default. It continually has a strong demand and despite these important arguments in favor of extending it, the budget request for the administration would once again reduce it substantially.

I want to point out that Ohio's Air Quality Development Authority executive director, Bill Elliott, told us in November that "access to the public capital markets may mean the difference between staying in business and closing down" for many of these businesses. The guarantee program is essential, and unless there is some new program or proposal to replace it, it should not be so quickly abandoned.

Thank you very much, Mr. Chairman.

Mr. BEDELL. Thank you very much, Mr. Eckart. I think the chairman should take note that we have 100 percent of our subcommittee here at this time and I should also mention to the subcommittee members that we will have a markup of H.R. 1362 next Tuesday morning here.

Mr. Conte, I understand you also have another meeting that you have to attend and I would yield at this time to you for your opening statement.

OPENING STATEMENT OF HON. SILVIO O. CONTE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MASSACHUSETTS

Mr. CONTE. Mr. Chairman, this is the second time that this committee has met within the space of a few months to try to get to the bottom of the problem that continues to plague the SBA pollution control bond guarantee program. Despite clear signals time and time again from this subcommittee, the full committee, the Appropriations Committee and the Congress as a whole, it appears that the program is still at a virtual standstill. Small businesses are going begging for a means of financing compliance with pollu-

tion control requirements mandated by the Congress and by the Federal Government or by State and local government.

This time it appears that in addition to the other roadblocks that are holding up the program, the executive branch has restricted the program to taxable finances only, despite the very clear legislative history and the authorizing legislation indicating congressional intent that tax-exempt financing be eligible for the guarantee.

Yesterday, the full committee sent another signal, as bipartisan as a congregation of moose in the mating season, that we will seek legislation, if necessary, to enforce our intent to this program.

I want to congratulate you, Mr. Chairman, for this hearing since this offers the opportunity to make the record unequivocal on two counts. First, that small business will find it extremely difficult, if not impossible, to comply with pollution control mandates if we force them to rely on taxable financing. Second, that the Government will not gain a nickel by restricting this program to taxable financing.

I look forward to hearing from the witnesses today as a positive step in breaking the logjam in this program. Sorry that I do have a full Appropriations Committee meeting at 9:30, but I will stay and I will be talking to you right along.

Thank you.

Mr. BEDELL. Thank you very much, Mr. Conte. We certainly appreciate the cooperation you have given us on this issue.

Mr. Molinari.

OPENING STATEMENT OF HON. GUY V. MOLINARI, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. MOLINARI. Thank you, Mr. Chairman.

I am pleased to be here at this hearing, which is the second that the subcommittee has held on the SBA pollution control bond program. This is the third hearing in a row that this subcommittee has held on environmental topics and they mark somewhat of a shift in focus away from energy problems, which are mercifully receding somewhat on account of the apparent oil glut, and more toward the environment.

The administration and the Congress are now in the process of reexamining the Federal role in protecting the environment and that is a process that must be carried out with great care because it relates directly to our health and well-being and I welcome the subcommittee's activity in this area.

At this point I would like to extend my appreciation to the chairman, Mr. Bedell, for the field hearing that he held in my district approximately a month ago, at which we heard some very, very disturbing testimony. The subject was that of waste oil and waste oil recovery. One particular problem we uncovered was the fact that waste oil contaminated with such highly toxic substances as PCB was being buried in buildings and apartment houses throughout New York City. One of the reasons for that problem is that there is apparently no easy or safe way to dispose of waste oil or toxic substances like PCB, but there is a potential solution. We heard testimony from a witness who had just built the only waste oil refining plant in the State of New York.

Not only can re-refining keep lubricating oil in circulation for use after use, but there is also a process that can destroy PCB's. What is more, and of great relevance to this hearing, that re-refining plant was made possible through financing provided under the SBA pollution control bond guarantee projects.

Also, participating in that hearing was the Independent Lubricating Manufacturers Association. I understand that they are going to be represented here today to testify. They indicated that recycling lubricating oil was important not only to protect the environment, but also to preserve a diminishing resource of feedstock. They also indicated that they were eager to become involved in re-refining, but like the other witness could only do so with the assistance of the SBA pollution control guarantee program.

I am pleased to see them following up on their interest at this hearing and I welcome them. I would like to end by saying that in the absence of programs, with the SBA's pollution control gone down the pike, we can see a repetition of what we have seen in my State time and time and time again, and that is the illegal disposal of toxic substances and a great threat to the health of people that we represent.

Thank you, Mr. Chairman.

Mr. BEDELL. Thank you, Mr. Molinari. I appreciate your involvement in the re-refining issue and the toxic substances. It appears to me that this is hand-in-glove with the hearing we are having here today because of the importance of trying to provide some sort of financial help.

Mr. Hiler.

OPENING STATEMENT OF HON. JOHN HILER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF INDIANA

Mr. HILER. Thank you, Mr. Chairman.

I, too, would like to compliment the chairman on holding these hearings. Having been in the foundry business before I took up this life, I understand, I think, what effect the cost of compliance with the rules and regulations in the pollution area——

Mr. CONTE. You go from one hot job to another.

Mr. HILER. Thanks, coach. Boy, you talk about breaking up my statement.

I think I can understand what effect the cost of compliance has on the small business community. Pollution control financing for small businesses is among the most important issues this subcommittee and, indeed, the full Small Business Committee, has addressed. It entails consideration of the proper role of the Federal Government when, in pursuit of one social good, it threatens many other social goods. In this case it is difficult to argue against the importance of controlling pollution; yet, it is even more difficult to ignore the severe burdens on the small business community.

In pursuit of cleaner air and water, the Federal Government is forcing small businesses out of business, thus jeopardizing productivity and jobs when our Nation needs them most. These are among the most essential issues these hearings address and these are the problems the pollution control guarantee program seeks to correct.

As we begin this particular hearing of the series, it may be helpful to recall testimony that reveals how Federal regulations affect one industry, as described by the Cast Metals Federation for the November 4, 1981, hearing. In its statement for the record, the Cast Metals Federation noted foundries have spent and continue to spend abnormal amounts of capital to meet the mandatory requirements. Expenditures for OSHA and EPA equipment amount to approximately 30 to 35 percent of total capital expenditures.

This financial drain forces most foundry managers to search for the necessary additional capital to make much needed productivity improvements. The growing restrictive nature of air emission regulations, tighter emission limits, commitments for secondary air quality standards and visible emission limitations will continue to be felt by older existing facilities which are still required for operation in the future.

Modernization and replacement programs for productive equipment will suffer unless reasonable financing to qualifying small businesses is possible. Quoting the study entitled, "Small Business Performance in the Regulated Economy" by Kenneth Chilton and Murray Weidenbaum, the CMF further noted in the late 1960's, that the foundry business began to lose small plants, those that specialized in small orders of less than 400 pieces a year, due to the combined effects of economic recession and EPA regulations. The size of the EPA mandated emission control expenditures for many of the foundries exceeded the net worth of the entire operation.

In the period 1968 through 1975, there were 350 verified foundry closings. Thirty-four percent of those closings cited EPA regulations as partial or total cause for the foundry closure.

This testimony clearly reveals, I believe, the severity of the dilemma, yet by definition "dilemmas" are solvable, and that is our purpose here today.

Thank you, Mr. Chairman.

Mr. BEDELL. Thank you very much, Mr. Hiler and we are fortunate to have someone with practical experience on our committee in this regard.

Mr. Mavroules.

OPENING STATEMENT OF HON. NICHOLAS MAVROULES, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MASSACHUSETTS

Mr. MAVROULES. Thank you very much, Mr. Chairman. Let me also commend you for early hearings on this very important matter. Again, I want to thank you once again publicly for your appearance in my district when we had a very meaningful hearing back about 6 or 8 months ago.

Today we are discussing an issue that could have a definite adverse impact on our environment, if it is carried out, namely, as we all know, the proposed curtailment of the small business pollution control facilities finance and guarantee program.

It is only within the last decade that our country realized that pollution was endangering our health, our air, and our water. Society, and hence Government, mandated that businesses take special measures to control pollution emissions from their facilities. Also,

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when these pollution control laws were enacted, it was recognized that they would entail substantial financial burdens and, therefore, Congress established several programs to help with pollution control financing. Specifically, it was realized that the small business community would need the most assistance in making expenditures needed for them to comply with the law.

At the hearing last November, a witness from the Massachusetts Industrial Finance Agency confirmed this attitude. He stated that pollution control expenditures by small companies are basically nonproductive expenses to the company. They are for a social goal, but to the company they do not add to its profitability, and in fact they merely add to the expense. High interest rates do nothing more than increase that burden. A case in point is the Springfield Foundry Co., and my dear colleague, Mr. Hiler, just alluded to that, which was required by EPA and OSHA to install an emission control in their filtration system to protect the company's workers and environment.

The company has only 115 employees and less than $5 million in sales. Without the $875,000 IRB and SBA guarantee for the new equipment, the company would have faced a very severe financial burden. We are now faced with an administration policy of not providing assistance to those which should be able to afford to help themselves. However, in the case of pollution control investments, this is not the case.

Businesses are not investing in pollution control equipment for the fun of it; they are making the investment because society made the judgment, and the law is forcing them to comply with that. Small businesses especially will be caught in a no-win situation if the program is curtailed.

On the one hand, they are threatened with shutdowns and fines if they do not install pollution equipment. On the other hand, without such loan guarantees, they are faced with substantial expenditures, which will do nothing to increase their productivity and can force them out of business.

The Government, therefore, should be helping small businesses to make this investment for the sake of society. Specifically, in my own district of Massachusetts, the need for small business loans for pollution control equipment is just beginning. We are, indeed, a major tanning center. Water pollution control laws are severe and bound to place a heavy financial burden on the tanneries. They are already worried about what they are going to have to do, and the demand for financing is bound to be enormous, or the entire tanning industry may be threatened.

When I talk about the entire tanning industry, I think it is a national issue because, directly and indirectly, through the tanning industry which includes chemicals, we are referring to the employment of about 1.5 million people. There is every reason to believe that there continues to be a steady increase in the need for pollution control financing assistance, and at the same time that these programs are being curtailed by the Federal Government.

Therefore, at least in my opinion, and I hope in yours, it is simply shortsightedness on the part of the administration to try to save the Government some money at the expense of small business-

es, forcing these companies to close, companies which employ workers and pay taxes.

Thank you very much, Mr. Chairman.

Mr. BEDELL. Thank you Mr. Mavroules and we appreciate the importance of small business in your particular area.

Mr. Hatcher.

Mr. HATCHER. I don't have a statement.

Mr. CONTE. Mr. Chairman.

Mr. BEDELL. Yes.

Mr. CONTE. Let me say that I am very disappointed that neither OMB nor Treasury sent a representative here today. This puts SBA in the hot seat, which may be undeserved, but I may confess that I may know why Treasury is not here, and I am still waiting for a reply from them to a letter I sent them on January 11, and another letter on February 11, asking why they have not complied with sections of Public Law 97-92, the so-called third continuing resolution, which I sponsored, that halted the enforcement of Revenue Ruling 81-216. I think we ought to make one more try and maybe just even have a special hearing for them. They ought to be up here like anybody else to answer these questions. [See app. A, exhibit 1.]

Mr. BEDELL. I think we should find out the will of the committee. The Office of Management and Budget was asked to be here to testify. My understanding is that they said that no one from there could testify, except David Stockman, and that Mr. Stockman had an appointment, which I think is quite understandable, frankly, that he couldn't be here. It is a little bit difficult for me tc understand that the agency would not have anyone else that could testify on this.

It is my further understanding that they were to have arranged for someone from Treasury to be here. Could I ask the staff to explain what the situation is, so we can then find out the will of the committee?

Mr. Rosenberg.

Mr. ROSENBERG. The Office of Management and Budget was invited by letter from the committee. Their response was that Mr. Stockman is not available today, and no one else could testify on behalf of OMB and that they thought, perhaps, a representative of the Treasury Department would satisfy the committee's needs. [See app. B.]

They were informed last week that the committee would be happy to have a representative of the Treasury Department appear here. On Monday afternoon we were informed by telephone that the Treasury Department would not be able to provide a representative either. The Office of Management and Budget, and the Treasury Department were then advised by staff that the committee would reserve the right to invite them at a future hearing date, but that it was unlikely that the members would want to delay this particular meeting.

Mr. BEDELL. What are the wishes of the committee?

Mr. CONTE. I certainly feel that Treasury ought to be here. We have written two letters to them. They haven't answered; they have given us no opinion on this. They are the ones that really have to make a decision on this, and this committee has some very

good questions to ask them. They ought to be here. I think it is an affront to you, the committee, and the Congress.

Mr. MAVROULES. Mr. Chairman.

Mr. BEDELL. Yes.

Mr. MAVROULES. Would you yield to me please, Sil? Are there any legal means that we can use to make sure that they appear before this committee? I strongly support the initiative of my colleague from Massachusetts.

Mr. BEDELL. There are legal means. I am not sure that we are where we need to use those yet. I would think that the first step would be to simply—if the committee wishes to make its will known—have someone move that we ask them to come back, where we would have a hearing so we could have a chance to hear them. It seems to me it is only proper that we do that before we proceed with anything more formal. We could, of course, subpena them to appear before us, but my personal opinion is that would be premature at this time, but it certainly would not be improper if it is the wish of the committee for us to have someone move that this committee ask they attend.

Mr. HILER. Mr. Chairman, I would move that we certainly reinvite Treasury. I am not sure that OMB would be absolutely necessary. It is Treasury that will enforce the ruling and I would certainly move that we reinvite Treasury and tell them that we will schedule the hearing when they tell us they can make it; I think we should have one.

Mr. BEDELL. Is there a second.

Mr. MAVROULES. Second.

Mr. BEDELL. All those in favor, say "aye."

[There was a chorus of "ayes."]

Mr. BEDELL. Opposed?

[There was no response.]

Mr. BEDELL. The staff will be ordered to do so, and we appreciate your help on that, Mr. Conte. I think it is fair to say that, at least in the opinion of the chairman, there is some question as to whether what they are doing is legal. I think we ought to at least state that issue because at least as we look through the previous legislation, I think there is a great question as to whether they can properly say that they are not going to make this financing available through revenue bonds, and it seems to me we should fight that issue.

If I read this committee correctly, there is pretty much unanimous feeling that this is a very urgent issue for small business, so we will proceed in that manner.

The Chairman did not finish his statement because of the fact that several people had commitments that they had to meet and I would like at this time to complete my statement.

It is regrettable that there appear to be some in the administration who differ with the views expressed by the members of this subcommittee. The folks at the Office of Management and Budget have tried several times within the past year to effectively eliminate this program through various backdoor maneuverings. Congress, in completely bipartisan moves in both Houses, has sent repeated messages to the executive branch that we want this program run at its full funding level and operating as outlined in the

law, and yet the administration persists. In the meantime, it is the small business community that suffers.

We will, of course, discuss all of these points with our witnesses. Before we do that, however, I believe it would be useful to review some recent events.

By the end of fiscal year 1981, the SBA had approved about $91.5 million in pending loan guarantees. The paperwork had been completed, and the applicants had been told that they would get the go-ahead as soon as new budget authorities became available. The administration requested $110 million in new loan guarantee authority for fiscal year 1982 and the Congress increased that figure to $250 million.

According to the testimony we heard last November, the OMB directed SBA to limit the program to $95 million in 1982, effectively shutting out any new entrants into the program and ignoring the much higher authorization level. On November 5, the day after our hearing last year, OMB announced that the program level would be dropped even further to $50 million. Congress responded several weeks later by including in the continuing resolutions language directing that the program be maintained at least to the $175 million level in 1982.

OMB's next gambit came in early January when they decreed that SBA could issue up to $150 million in pollution control loan guarantees this fiscal year. However, they added the condition that the guarantees may not be used to back any tax-exempt financings. This, of course, completely reverses the 6-year history of the program and ignores the clear intent of Congress.

Within the past few weeks, the Appropriations Committees of both the Senate and the House have rejected the administration's proposal to limit fiscal year 1982 program authority to $150 million, and more recently the Small Business Committees of both the House and the Senate have rejected the administration's newest proposal, to lower the authorization level to $150 million for fiscal year 1983 as well. Instead, both committees have indicated they are again prepared to authorize $250 million.

Moreover, at yesterday's full committee meeting it was Joe McDade, speaking on behalf of the Republican members of the Small Business Committee, who led the challenge to OMB's restrictions on tax-exempt financings. He drew unanimous support on that point.

I am taking the time to review all of this because I want to make sure everyone understands that the Congress has been completely clear and steadfast in its support for the SBA's pollution control loan guarantee program.

The record compiled at our November 4, 1981, hearing shows without question that this is a well-run, efficient, and effective program. Without any outlay of funds, this program has managed to help hundreds of small businesses meet their pollution control requirements and continue in operation. In point of fact, this program has actually added millions of dollars to the Federal Treasury while never suffering a single default in its history. With these facts in mind, we find the administration's policy and actions regarding the SBA pollution control loan guarantee program to be incredible.

In today's hearing, we will seek to understand just what the administration is planning to do, and what the likely consequences will be.

Our first witness is the Acting Administrator of the SBA, who will be followed by a representative of State government agencies. From the private sector, we have several small businessmen who have had personal experience with the pollution control loan guarantee program.

It is my understanding that Mr. Templeman, who was to have been here for the Small Business Administration is ill, and Mr. Ed Holloway will appear in his stead. We appreciate having you here, Mr. Holloway. I think at least the chairman of the committee understands somewhat the position you are in, and the chairman would tend to give you his sympathy. You may proceed.

Mr. HOLLOWAY. Thank you, Mr. Chairman.

I am pleased to have this opportunity today to discuss the Small Business Administration's pollution control financing guarantee program.

Mr. BEDELL. Excuse me. Can you hear in the back? Let us know if you cannot.

TESTIMONY OF EDWIN T. HOLLOWAY, ASSOCIATE ADMINISTRATOR FOR FINANCE AND INVESTMENT, SMALL BUSINESS ADMINISTRATION, ACCOMPANIED BY HARRY S. CARVER, COMPTROLLER; AND VINCENT A. FRAGNITO, PROGRAM DIRECTOR FOR POLLUTION CONTROL, SBA

Mr. HOLLOWAY. I am Edwin T. Holloway, Associate Administrator for Finance and Investment. With me today are Harry S. Carver, Comptroller, and Vincent A. Fragnito, Program Director for Pollution Control.

As you know, the agency testified on the pollution control financing guarantee program before this subcommittee on November 4, 1981. Since that time changes have occurred affecting the program and its operation. First, as part of the President's decision to reduce 1982 new commitments for Federal loan guarantees, the level of guarantees for pollution control equipment was reduced to $50 million.

SBA advocated an increase to $150 million which was approved by OMB with two caveats: (1) That the increase in pollution control guarantees be offset by a reduction in other SBA programs, and (2) that the guarantees be limited to loans or contracts that are financed from the proceeds of taxable, rather than tax-exempt, bonds.

Notification of the change in program levels, was sent to the Senate and House Appropriations Committees. Both committees have objected to the change, and we have submitted a reapportionment request for a $250 million level in fiscal year 1982, which is pending at OMB. Because of the change from tax-exempt to taxable financing, it is not presently possible to predict the demand for this program in fiscal years 1982 and 1983. Since December of last year, the spread between the interest rate on taxable and tax-exempt bonds of a 20-year financing has been modest and we have an attachment to the statement illustrating that. However, the securi-

ties industry now states that this small spread in interest rates is unusual and may ultimately increase to a range of 2.5 to 5 percent. Thus, while no change was made in the eligibility requirements for program participants, some applicants may not qualify for financing if the increased cost of money is substantial.

Presently, SBA has $129 million of pollution control applications which have been received during the past 18 months. There are $35.6 million in commitments outstanding and the remaining $93.4 million are to be processed.

As a result of this decision, it became necessary for SBA to write each applicant advising them of the change to taxable financing and requesting that they consider restructuring their pollution control financing needs to a taxable basis. We also requested each applicant to advise us how they plan to accomplish the restructuring.

Of the almost 120 letters sent to applicants we have received responses from 32 small concerns, which have requested that we consider their applications on a taxable financing basis. Five companies have withdrawn or canceled their applications to date.

In addition to sending letters to all applicants advising them of the change in guarantee authority, analysis is presently underway to determine the overall creditworthiness of those applicants who can demonstrate the ability to handle the more costly taxable pollution control financing. When this is complete we will be in a better position to recommit guarantees on taxable financings.

SBA has continued to examine the ramifications of changing from tax-exempt to taxable financing guarantee authority for this program. We are currently discussing this issue with the Office of Management and Budget. We feel that through the agency's cooperation with the private sector, we can continue to assist small businesses in obtaining the required pollution control financing through private sector financial institutions.

Mr. Chairman, I wish to express my appreciation for your invitation and for providing the opportunity to appear here today. The data on program activity since January 1980 requested in your letter is in the appendix to this statement. We will answer to the best of our knowledge any questions that the committee wishes to ask.

Mr. BEDELL. Thank you, Mr. Holloway.

Mr. Mavroules.

Mr. MAVROULES. Thank you, Mr. Chairman, and thank you, Mr. Holloway, for your testimony this morning. I just have two questions; I will ask them both and then maybe you can respond to them.

How much demand is out in the market today, and does SBA know whether demand for this program is growing or declining? That is item No. 1, because there were some statements made yesterday when we were going over the budget.

Second, SBA currently has only two professionals and a secretary working on processing pollution control loan guarantees. If all funds were suddenly released and the program suddenly grew to $250 million a year, could the present personnel handle this increase without undue delays? Are there any other plans to assign additional people to work on this if the money starts to flow again?

Mr. HOLLOWAY. Congressman, with respect to your first question on how much demand, certainly, the answer to that will ultimately depend on whether this program is operated on a taxable or tax-exempt basis. We have gone out to roughly 120 applicants whose applications are pending before the administration at this time, asking them to submit any additional information they could that would support their applications if the financing is accommodated on a taxable rather than a tax-exempt basis.

So, we really will not know until we get responses to most of those 120 letters, indicating from the actual applicants themselves their interest in pursuing on a taxable basis. If the financing is accommodated on a tax-exempt basis, I think it is fair to say that there would be at least $150 million worth of demand this year and next.

Mr. MAVROULES. Do you think the changes recommended by OMB enhance greater opportunities for those out in the field or do you think it curtails their own initiatives?

Mr. HOLLOWAY. I am sorry, Congressman, I didn't understand that.

Mr. MAVROULES. The OMB has proposed certain changes.

Mr. HOLLOWAY. Yes, sir.

Mr. MAVROULES. What is your opinion on the changes that they have effected up to this point?

Mr. HOLLOWAY. The short of the changes is that a higher rate, possibly in the range of 2 to 4 or 5 percent will be the result. Accordingly, the small businesses concerned would be that much less interested or that much less able to support the necessary cash flow requirements to operate on that basis.

Mr. MAVROULES. Finally, back to the question of personnel. How would you address that?

Mr. HOLLOWAY. On the question of personnel, I am aware of the resource restraint that we have in that particular section, and am currently making an effort to get some additional help there. Should we have a lot of demand or should this program go back at any time to a tax-exempt basis, I can assure you that we will take the necessary steps to beef up Mr. Fragnito's operation over there to make the necessary personnel available.

Mr. MAVROULES. Thank you.

Thank you, Mr. Chairman.

Mr. BEDELL. Thank you very much, Mr. Mavroules.

Mr. Holloway, last November apparently, according to testimony at that time, you had had no actual losses on this program. You had two that had to be refinanced, I think. Is that situation still the same or has it changed since that time?

Mr. HOLLOWAY. All right. Go ahead.

Mr. FRAGNITO. Mr. Chairman, we have presently six companies in default. We have had no losses. We have paid out close to $1 million, I believe, in actual default payments. So, defaults have occurred. There were three in default at that point at the last hearing.

Mr. BEDELL. Just so I can understand, what are default payments?

Mr. FRAGNITO. Technically a company is in default when it misses the first payment. However, there is a reserve fund require-

ment which amounts to three monthly payments. This fund is utilized first before SBA is called upon to make any payments.

Mr. BEDELL. Then, if that is the case, you make the payments for them.

Mr. FRAGNITO. We start making payments and we counsel them in a workout situation to see what their problem is and when they are going to resume payments.

Mr. BEDELL. How much do you have out in loan guarantees?

Mr. FRAGNITO. We have about $½ billion.

Mr. BEDELL. So, you have $500 million out.

Mr. FRAGNITO. In contingent liability, that is, principal and interest liability.

Mr. BEDELL. You have in default at this time about $1 million.

Mr. FRAGNITO. About $1 million.

Mr. BEDELL. So, that is about two-tenths of 1 percent.

I take it that it is your opinion that without the tax-exempt feature it is going to significantly impinge upon the number of small businesses which can effectively use this program. Is that correct?

Mr. FRAGNITO. Primarily because of the higher interest rates.

Mr. BEDELL. Because of the higher interest rates.

Mr. FRAGNITO. The debt service is much higher, and it is more difficult for a company to meet those.

Mr. BEDELL. Have you had your legal staff look at this at all, or not? There has been some question, at least in the chairman's mind, as to whether it is legal for the Treasury Department to say that OMB or whoever is responsible, to say that they will not be permitted to use tax-exempt bond financing in this program from reading the legislation. Have you had your people look at that?

Mr. HOLLOWAY. Yes, Mr. Chairman, I understand that it is an opinion of SBA counsel that at least insofar as the requirements of the law are concerned, that the program could be operated either on a taxable or a tax-exempt basis, that there is nothing in the statute that restricts it to these tax-exempt situations only. There is an opinion of counsel, which we could submit to the committee.

Mr. BEDELL. Yes, I don't think the question is whether it restricts it to that. I think the question is whether it is legal to restrict it to exclude that, if you understand what I mean.

Mr. HOLLOWAY. Yes, sir. I understand what you mean.

Mr. BEDELL. Do you have counsel which told you that they felt that it was perfectly legal to exclude tax-exempt financing?

Mr. HOLLOWAY. The opinion is an older one, not precisely on that point, as to whether or not it is legal to exclude. It is on the basis of some years ago that the program, by virtue of the basic statutory authority, could be operated on either a taxable or tax-exempt basis.

Mr. BEDELL. Would you be amenable to checking with your legal staff and find out whether, in their opinion, it is legal to exclude tax-exempt financing? If you would provide that for the record——

Mr. HOLLOWAY. Yes, we will provide it.

[As of June 1, the committee had not received this information.]

Mr. BEDELL. Our committee report on this SBA program says pollution control guarantees are for tax-exempt financing. It has been pretty well accepted that this is the case and I think, as you know, members of the committee are very disturbed over it.

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Mr. HOLLOWAY. Yes, sir.

Mr. BEDELL. I think we recognize your position. I hope we would recognize your position as to the fact that you may not be calling all the shots.

Mr. HOLLOWAY. Yes, sir.

Mr. BEDELL. Is there anything more? If not, we really appreciate your coming.

Mr. ROSENBERG. The committee has heard some discussion that there may be Government-guaranteed taxable bonds offered as a possible alternative to the SBA backing tax-exempt bonds. We are somewhat puzzled by this since a review of the financial marketplace hasn't turned up many instances of Government-guaranteed taxable bonds. Can you tell us anything about that proposal?

Mr. HOLLOWAY. At the time the President proposed a $50 million level for this program, we, at SBA, went to OMB and appealed this level because we felt that it would be best to have at least an additional $100 million that we could guarantee on a taxable basis. Otherwise the program would have to be shut down and have nothing available on any basis because by that time we had used up some $40 million of the $50 million.

Mr. ROSENBERG. So that proposal for Government-guaranteed taxable bonds is no longer receiving your consideration?

Mr. HOLLOWAY. No, it is still receiving our consideration. However, we are exploring with the OMB the possibility of at least a transition period longer than we had, whereby we could continue to do some tax-exempt financing perhaps for the balance of this fiscal year and proceed with developing a program on a taxable basis over a longer term.

Mr. ROSENBERG. Is it fair to infer from what you are saying that the imposition of a sudden termination of all tax-exempt financing through this program is creating a disruption in the pollution control financing program?

Mr. HOLLOWAY. There is admittedly disruption when the rules change on rather short notice.

Mr. ROSENBERG. I have no further questions.

Mr. KULIKOWSKI. Mr. Conte has asked me to submit for the record a document from OMB to SBA in which OMB sets forth the portion of pollution control bond guarantee and I believe it is in this document that OMB indicates or sets forth instructions, or what have you, that tax-exempt bonds would no longer be eligible for financing.

Mr. BEDELL. It will be admitted. [See app. A, exhibit 2.]

Mr. KULIKOWSKI. Just one question in connection with the turnback of the reprograming request, which was recently sent out of Mr. Smith's subcommittee of the Appropriation Committee. Do you interpret that turnback as having any effect on the policy?

Mr. HOLLOWAY. We, after receiving that, have asked OMB for a reprograming at the $250 million level. We have not yet formalized an appeal to OMB that the program be carried out, at least during a transition period on a tax-exempt basis.

Mr. KULIKOWSKI. Is it your position then that the turnback on the Appropriations Committee does not speak to the tax-exempt issue?

Mr. HOLLOWAY. It did not speak specifically of the tax-exempt issue.

Mr. KULIKOWSKI. So that would leave it, I guess, to this committee then. I think, if you were looking for instructions from the Congress as to tax-exempt issues, you would——

Mr. HOLLOWAY. I think that would be correct.

Mr. BEDELL. Thank you very much and I think maybe it would be appropriate in the markup next Tuesday, we might try to arrange a resolution of some kind that we could move on at that time.

Mr. HOLLOWAY. In terms of our exploring the matter with OMB, it would.

Mr. BEDELL. We appreciate your testimony very much. Thank you.

Our next witness is Jean Laubach, executive director of the Small Business Finance Agency for the State of Minnesota.

The chairman would like to announce that he has some constituents from his district here. I am very sorry that I cannot very well break away, as we don't have anyone else to take over the subcommittee, but I appreciate your being here very much.

TESTIMONY OF JEAN LAUBACH, EXECUTIVE DIRECTOR, MINNESOTA SMALL BUSINESS FINANCE AGENCY, AND MEMBER, COUNCIL OF POLLUTION CONTROL FINANCING AGENCIES

Ms. LAUBACH. Mr. Chairman, members of the committee, I am Jean Laubach, executive director of the Minnesota Small Business Finance Agency, and a member of the Council of Pollution Control Financing Agencies. The council is a nonprofit organization formed by local and State agencies which serve as issuers of tax-exempt financings for pollution control and solid waste facilities. The council includes associate members from the financial, legal, and industrial sectors. Council members have been active in supporting the availability of tax-exempt financing as an important part of the Nation's effort to achieve environmental goals and foster economic development.

On behalf of the council, we welcome this opportunity to provide the committee with our views regarding the current status of tax-exempt financing of pollution control facilities.

Mr. Chairman, I am here to tell you and the members of the committee that the administration's decision to deny guarantees to tax-exempt pollution control bonds is an arbitrary and capricious act, which, if left to stand, will result in numerous small- and medium-sized businesses that are unable to finance the necessary equipment to meet compliance standards and will be forced out of business.

Simply put, these companies cannot gain equal access to the capital markets required to install pollution control facilities. Even if they could, they could not carry the costs of capital. This is especially the case under current conditions with real interest rates hovering around the 18-percent mark. Denial of pollution control loan guarantees for tax-exempt bonds will only increase the severity of the already dire situation as firms attempt to expand and are

unable to acquire capital to install pollution control facilities mandated by Congress.

The SBA pollution control loan guarantee program has played a vital role in minimizing the discrimination small businesses have traditionally faced. Lenders view these concerns as high risks and are therefore reluctant to provide them with capital to finance pollution control facilities. By making guarantees available to these firms, the SBA program has enhanced the financial attractiveness to lenders of making loans to small businesses, thereby enabling them to comply with environmental requirements.

There is another side to this program that deserves attention. This is the contribution the program makes to the budget on the revenue side.

Since its inception, this SBA guarantee program has been a revenue raiser through the fee SBA levies on businesses using the guarantee. To date, the fee system has generated $25 million. Translated into program outputs, this means the program is self-sustaining. It costs the Federal Government nothing and, more importantly, fosters economic activity throughout the country.

In Minnesota we have submitted applications for guarantees for a tanning facility to meet water standards, an oil distributor to prevent runoff into soil, and a solid waste disposal operation. Time does not permit a review of the several beneficial uses of these tax-exempt issues, so I have attached other examples for the committee's review.

From the council's perspective, taxable issue guarantees are an unrealistic alternative to the tax-exempt program. Small- and medium-sized businesses will find it difficult, if not impossible, to secure credit on taxable terms because they pose too great a risk to the lender.

As evidence of the lack of enthusiasm for the taxable guarantee alternative as a viable option, I draw your attention to the response SBA received following its retroactive policy change concerning the termination of the tax-exempt program. SBA notified over 100 businesses to either switch to the taxable guarantee route or face withdrawal of their applications. In response, at the time one firm out of this total notified SBA of its desire to seek a taxable guarantee. This is only for the principal of the loan. Clearly, the large majority of these companies believe, as I do, that the costs become prohibitive under the taxable guarantee option.

The absence of applicants for taxable guarantees suggests several points: First, the Federal Government loses a source of revenue; second, small- and medium-sized businesses will be forced to compete with large firms that have the advantage of offering stability to potential lenders; and third, the SBA and this administration are telling small businesses—the largest source of new jobs and economic growth in this country—that they are not deserving of special consideration during these times of economic turmoil. In this adverse business climate, in which even major corporations are on the financial brink, it makes no sense blithely to remove an integral component of the small business lifeline, a lifeline that results in a major source of new jobs and increased economic activity.

Congress specifically mandated tax-exempt issue guarantees in Public Law 94-305. On several occasions last year, Congress recon-

firmed its commitment to tax-exempts and advised SBA to make these guarantees available. Despite these congressional directives, the SBA and this administration continue to flaunt Congress intent. It is for this reason the council of pollution control financing agencies urges this committee to take whatever steps are necessary to insure the speedy provision of these loan guarantees.

I would like to take this opportunity to quickly review some of our concerns regarding proposals to limit or curtail the availability of tax-exempt financing of pollution control facilities.

The administration recently unveiled its plan to raise additional revenues. The plan includes a proposal to curtail the availability of pollution control financing with tax-exempt bonds. One of the primary assumptions of this plan is the need to reduce the Federal Government's crowding the private sector in the capital marketplace. This administration's proposal does exactly the opposite, however, by encouraging firms to seek taxable loans which the SBA would then guarantee. Unfortunately, businesses that can secure the loans are probably those that do not need the guarantee.

Another major rationale behind the administration's proposal argues that tax-exempts for pollution control financing serves a quasi-public purpose, thus creating undue competition for financing other municipal services. Restricting the availability of pollution control financing, the administration points out, will lessen this competition.

In our view, this reasoning is flawed. These bonds finance the purchase of pollution control facilities mandated by the Clean Air, Clean Water and the Resource Conservation and Recovery Acts. The public, in overwhelming majorities as illustrated in numerous surveys, supports these laws and their objectives. In short, tax-exempts finance a public goal: clean air, water, and land. Even more important, the country's citizens are the direct beneficiaries of mandated environmental cleanup efforts by both the public and the private sectors.

The administration further posits, and I quote from its explanation of the tax proposal,

> Businesses requiring pollution control facilities, through the use of tax-exempt financing, creates a bias in favor of investment in those activities.

Mr. Chairman, those investments are mandated by statute at the Federal, State and local levels of government. Is this to suggest the administration implicitly endorses violation of these laws, which may lead to a deteriorated quality of life?

The administration also is concerned over double-dipping benefits received from using both ACRS and tax-exempt financing for pollution control. It believes revenue losses from ACRS depreciation, coupled with tax-exempt bonds, is unwarranted. This is a philosophical issue which is subject to debate. However, we are working with real life situations.

The denial of tax-exempt financing means we hamper any hopes of sustaining economic recovery, because a business plant expansion and modernization require affordable capital for the unproductive costs of pollution control facilities. This is only available through tax-exempt financing.

Of course, there will also be an environmental consequence. The lack of adequate pollution control facilities ultimately means noncompliance with environmental mandates resulting in enforcement actions against the violating business and a decreased quality of life.

Finally, there is the issue of revenue losses the Department of the Treasury incurs from this proposed tax policy. As businesses are forced to shut down, revenues from payroll and corporate taxes decrease and the productivity of the Nation diminishes. In essence, denial or restriction of tax-exempts therefore will mean higher prices and lower levels of productivity. This proposal ironically works to the detriment of the administration's economic recovery program because it stymies business expansion, an important part of which includes additional pollution control facilities.

The administration also proposes to require governmental units to make either a 1-percent commitment equal to the bond's face value or, alternatively, guarantee or insure the bond. This is nothing short of an attempt to eliminate the use of tax-exempts. First, only three States have the authority to provide a guarantee.

Second, as the administration pursues its "New Federalism," States and localities will be forced to assume the increased cost of financing additional services. Their ability to meet this 1-percent commitment is doubtful as deteriorating infrastructures demand commitment of scarce State and local resources. In effect, the Federal Government is demanding that we take on greater financial responsibilities, while at the same time it seeks to remove the tools that are needed to accomplish these new duties.

We welcome this reexamination of Federal, State and local responsibilities, but only so long as adequate tools are available to facilitate an orderly and effective restructuring of responsibilities over the long term. Tax-exempt pollution control bonds, coupled with the availability of sufficient SBA authority to provide pollution control loan guarantees, is one such tool and a critical one at that.

Mr. Chairman, this concludes my formal testimony. I would be happy to respond to any questions the committee may have at this time.

Mr. BEDELL. Thank you very much, Ms. Laubach. This is excellent testimony and you certainly make your point very effectively, in the opinion of the Chairman.

I think the one point you made, among many others, which is certainly critical, is that for anyone to say that this creates a bias in favor of these types of investments, the fact is that legislatively we mandated that bias and legislatively we have said that this has to be done. We could argue whether it is right or wrong for the Government to say that we have to do something about the pollution problems in our society, but that decision has already been made and the question now is whether we are going to give the help that is necessary.

Also, from reading your testimony, it appears to me that this has actually been a profitable thing for the Government. We just had SBA before us and they indicated that at this time the delinquencies that exist have required them to put out a million dollars so

far in covering those delinquencies and according to your testimony they have collected back $25 million in fees.

Ms. LAUBACH. Mr. Chairman, they charge a 3½-percent guarantee fee on whatever they guarantee. Historically, that has been of principal and interest, so that is where those revenue funds are derived from.

Mr. BEDELL. Well, we certainly appreciate your knowledge and expertise on this issue and the fact that you came in to give this testimony. I should say that Minnesota is not alone in regard to this feeling. We have already had testimony from Ohio, Massachusetts, and New York stating similar concerns. I believe the important thing is we have people such as you to make this committee aware that we had better do what we can to see that the program is an effective program, and you believe that without the tax-exempt bonds it really cannot be a very effective program, I take it. Is that the idea?

Ms. LAUBACH. Mr. Chairman, of the applications that we have had since the inception of the agency in September, all four applicants have recomputed the figures of debt service using a taxable rate and figuring in the cost of the guarantee at 3½ percent, and have found it to be cost prohibitive for all the companies. All the companies are under official mandates from the Minnesota Pollution Control Agency to meet requirements.

Mr. BEDELL. What are they going to do?

Ms. LAUBACH. The answer is unclear at this point.

Mr. BEDELL. But certainly it is possible that we could be actually legislating some firms out of business. Is that not correct?

Ms. LAUBACH. It will depend upon how forceful the environmental agency is and whether they would extend the time under which their mandate is to be met or if the company can find an alternative source of financing. The alternative of conventional financing is variable rate, tied to prime for a shorter period of time causing a cash flow drain that the company may not be able to sustain. The bank analyzes the equipment as a non-revenue producing expense and would prefer not to finance that, even at conventional rates.

Mr. BEDELL. Well, we certainly appreciate your testimony very much.

Ms. LAUBACH. Thank you, sir.

PANEL CONSISTING OF JACK SCHAEFER, ROBERT PATTERSON, AND EDWARD DURKIN

Mr. BEDELL. We will next have a panel of three people, Mr. Jack Schaefer of Specialty Papers Co. in Dayton, Ohio; Donald Schultz, National Metal Finishing Co., Springfield, Mass.; and Edward Durkin, Advance Plating Co. of Cleveland, Ohio.

I should say that Mr. Schaefer is president of the Small Business Coalition for Pollution Control. Mr. Schultz is a member of the Small Business Coalition for Pollution Control and Mr. Durkin represents the National Association of Metal Finishers. We need to get you identified so we know which is which here.

Mr. Schaefer.

Mr. SCHAEFER. I am Jack Schaefer. I am president of Specialty Papers Co. and I am also president of the Small Business Coalition for Pollution Control.

Mr. PATTERSON. Mr. Chairman, I am actually Robert Patterson, executive director of the Massachusetts Industrial Finance Agency, and I am sorry to report for reasons that I do not understand that Donald Schultz, who was going to accompany me here today, and I were going to meet on the airplane coming down early from Boston and I just don't know where Mr. Schultz is, but rather than hold you up, I would like to deliver his testimony.

Mr. DURKIN. I am Edward Durkin from Advance Plating Co. in Cleveland, Ohio, and I represent the National Association of Metal Finishers.

Mr. BEDELL. Thank you. You testified before, I think, did you not, Mr. Patterson?

Mr. PATTERSON. Yes, Mr. Chairman, I did.

Mr. BEDELL. Thank you. Shall we start with you, Mr. Schaefer?

TESTIMONY OF JACK SCHAEFER, PRESIDENT, SPECIALTY PAPERS CO., DAYTON, OHIO

Mr. SCHAEFER. Fine.

Mr. Chairman, I have a written statement that I have supplied to the committee which I would like to read at this time.

I would like to start out by thanking you for holding these committee hearings to learn more about this issue, and find out how it is affecting businesses in the country.

Both my company, and other members of the coalition—and I will be speaking for both as we go through—would like to express our frustration and uncertainty due to the administration's policy first to withhold guarantees authorized by Congress, and then for the OMB to retroactively announce in January that no guarantees would be closed after December 31, 1981 for tax-exempt financing.

Many applicants, including Specialty Papers, have been planning for several years to meet the cost of Government-mandated pollution equipment through SBA-guaranteed financing. To have the entire program virtually wiped out retroactively by administrative caveat is disastrous for many of us. As of a week ago, it is our understanding from the SBA that no taxable guaranteed loan has been closed, even though it has been approximately 2 months since that avenue of financing has been opened up.

It would appear that the issue resolves down to the advantages and disadvantages at the moment between tax-exempt and taxable financing. I think there are some underriding issues in that area that really have not come out this morning in these hearings that I think need to come out.

For a company like ours, or any of our members, to sell bonds, there has to be a market and we are being told by the underwriters that there is no existing financing method to sell taxable bonds. No market currently exists for such bonds because there has never been any such type of bonds issued.

Another factor which is at least as critical, if not more, is that as a taxable issue we are being told by counsel that an S–1 registration statement must be filed with the SEC and the cost of an S–1

registration statement is at least $50,000 and could likely be more; $50,000 is the minimum amount that has been quoted.

In addition, audited financial statements for at least 3 and perhaps as long as 5 years would be necessary. Many of these small businesses simply do not have a fully audited financial statement going back 3 to 5 years and, of course, the cost to obtain that would be astronomical.

In addition, the S-1 registration statement could take 9 to 12 months to get all the information together, prepared and printed. So, it is expensive, and it is delaying. The only possible avenue the underwriters tell us to place these bonds would be with probably a large pension fund, someone who is looking for a security and is not interested in marketability and, of course, the pension fund does not pay taxes on their income.

Due to the lack of marketability of the bonds, the interest rate that they would have to carry would have to be higher than the typical rate that is used by a Government-backed financing vehicle, such as a Ginnie Mae or Fannie Mae-type instrument and, of course, the interest rate would have to be very much higher than tax-exempt. I guess I question the figures that SBA prepared today to represent what the taxable rate would be because there is no comparable financial instrument available from which to draw a comparable taxable rate. I don't think anybody today knows how high that taxable rate would be. This is what we are being told by counsel.

The SBA guarantee fee, as mentioned earlier, is the maximum authorized by Congress at 3½ percent and since it applies both to the interest and to the principal, if you pay more interest under a taxable issue, you pay a much higher guarantee fee. So, the SBA is going to collect more money than the guarantee fee if the interest is taxable.

Large companies with access to public financing are continuing right today to raise very large amounts of money for pollution control as well as other things through tax-exempt financing because they can go to the public markets without any kind of Federal guarantee. That puts small companies, like Specialty Papers Co., and others in our coalition, at a severe competitive disadvantage.

Mr. BEDELL. Excuse me. Those wouldn't be tax-exempt, would they?

Mr. SCHAEFER. Yes, they would. Just in the last few months, Anheuser Busch is building a large brewery in the State of Ohio and once they were induced by Ohio Air or Ohio Water Quality or both, they are then free, as we are, to issue tax-exempt financing. The difference is that there is no public market for taxable bonds issued by Specialty Papers Co. or National Metal Finishers or whatever, because the general public never heard of them.

There is a market for Anheuser Busch's tax-exempt bonds because they are a very large, strong company, and they are well-known. So, there are today and there have been continuing tax-exempt bonds issued by companies whose financial strength is large enough that they have access to the public markets without any kind of guarantee fee. The guarantee by the SBA is really intended so that companies like ours will have the same accessibility

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to the public financial markets and puts them at parity with these very large companies.

Like many other applicants, my company is continuing to receive pressure from local and EPA authorities to install pollution equipment to meet the deadlines imposed by law. I attended a meeting as recently as last Friday with the local EPA officials and they are putting a lot of pressure on us and they want answers and they want to know when we are going to be able to comply. We have selected the equipment. We selected the equipment last fall, and the contractor and we are ready to proceed, but our hands our tied. We are looking at a $3.5 million project.

My company is an inner-city employer located in the black community of Dayton and has already borrowed over $200,000 from a local bank to purchase land for alternate parking, as the pollution control equipment will consume about 80 percent of our existing parking lot. We have already done that on our own. What we are trying to get the guarantee for is merely the equipment itself.

We need your help. We have met with SBA officials in Washington and they say their hands are tied by the OMB. The OMB has thus far been unwilling to meet with us. The SBA claims that the administration is concerned about the impact on the credit market. Yet, this seems unfounded as they have agreed to release some of the guarantees authorized by Congress provided it is for taxable financing.

Tax-exempt financing would not seem to impact the credit markets any more than does the taxable issue. Since its inception several years ago—as was brought out earlier—this program utilizing tax-exempt financing has been vital to many small companies. It continues to be vital. It has been one of the best programs ever undertaken by the SBA. It has profited the Government by over $20 million in Government guarantee fees with very minimal defaults.

A very important point that has not been brought out and I feel that as an applicant, as a company, we would be better off today if there never had been a program, than to have had a program and had companies like us planning to utilize that vehicle of financing, being led to the altar, and the rug being pulled out from under us. We had one arm chopped off, and we still have the EPA on the other side saying you still have to comply. We strongly encourage you to do whatever is necessary to reinstate this program on a tax-exempt basis because that seems to be the only practical way the program can survive.

Thank you very much.

Mr. BEDELL. Thank you very much for your testimony, Mr. Schaefer.

Mr. Patterson, please.

TESTIMONY OF ROBERT PATTERSON, EXECUTIVE DIRECTOR, MASSACHUSETTS INDUSTRIAL FINANCE AUTHORITY, ON BEHALF OF DONALD SCHULTZ

Mr. PATTERSON. Yes, if Mr. Schultz has not arrived. I guess he is not in the room. I am sorry that he has been unavoidably detained.

I would like to bring you his words, however. Donald Schultz is president of the National Metal Finishing Co. in Springfield, Mass.

I would like to give you some background on my company, which should offer some valuable insight into the necessity of combining these two programs for small business. Like most companies in the Commonwealth of Massachusetts, National Metal Finishing Co. of Springfield is a small, closely held firm originally founded in 1946. We perform a variety of metal finishing processes, including plating, polishing, deburring, and lacquering for a broad base of industrial concerns throughout the Northeast.

Our metal finishing operations serve the automotive, medical, electrical, solar heating, and computer markets. The company employs 85 people in the Greater Springfield/Holyoke area in good and productive jobs.

Last year, the Environmental Protection Agency told me to install pollution control equipment in my plant to meet current regulations and standards concerning chemical safety in the electroplating industry. I personally understand the need to protect our environment, and am willing to comply with any reasonable regulations to achieve this worthy objective. To comply with the EPA regulations, it is necessary for my company to build a 10,000-square-foot addition to our plant, and purchase $275,000 worth of pollution control equipment.

The price tag for the entire project is going to be $400,000. Now, to a national company with access to the best credit, $400,000 would hardly constitute much of a burden. To a small, independent company, this is a major investment, especially since the pollution control equipment will bring no profits in return. If this were the only result of making an investment that has no return, it would be bad enough. We, however, must add daily labor, communications, maintenance and then pay to have the industrial waste hauled all the way to Alabama without realizing any revenue on sales from the investment.

As a result, most investors are not willing to finance a pollution control project for a small company without a 100 percent SBA guarantee, for which my company has received a commitment. The SBA guarantee also translates into longer repayment terms on the loan, which is absolutely critical to a small business like mine.

In these times of devastating interest rates, however, the SBA guarantee is just not enough. During the past few years, tax-exempt industrial revenue bonds and pollution control bonds have offered the only opportunity for smaller companies to obtain loans at reasonable interest rates. So, in order to successfully obtain financing for pollution control equipment at an affordable rate, a small company must rely on an SBA guarantee of a tax-exempt bond.

Unfortunately, the Office of Management and Budget has suddenly taken the position that SBA guarantees should only be available for pollution control projects that are financed on a conventional, not a tax-exempt, basis. Though I am not able to explain the rationale for such a position, I can testify to the hardship that this sudden reversal in the middle of the SBA process, after being encouraged by the Government to proceed in this manner, has caused for my company and others like it in a similar predicament.

What the Federal Government is doing, on one hand, is forcing small businesses to live up to their responsibility of protecting the

environment, and then, on the other hand, it is removing the only reasonable financing mechanism for us to accomplish this. Small businesses are finding it difficult to strike a profit on even productive investment at today's interest rates, and most certainly will lose money on nonproductive pollution control equipment.

The net result, I think, will be more business failures and even more workers heading for the unemployment lines. Considering the current state of our economy, this is hardly a result our country can afford.

In summation, we who run small businesses are willing to do our part to protect the environment. We, too, have a commitment to our communities. But if the Federal Government is going to require us to comply with these regulations, then it should also provide us with the financing tools to meet those standards.

It seems that whenever big business is in trouble as a result of their own mismanagement, Government stands ready to step in and bail them out. Moreover, there has been ample publicity in recent months over the windfall provisions of big business in the administration's tax bill signed into law last year.

I am here today only to ask that Congress force OMB to continue for small business a program explicitly authorized by Congress to help small business clean up the environment. All the arguments about Federal revenue losses and crowding out in the credit market sound awfully complicated, but they overlook two simple facts: Big businesses are continuing to receive large tax-exempt bond issues for pollution control, and the SBA guarantee has been authorized by Congress, and will in any case be permitted by OMB. OMB's theoretical arguments are pretty obscure but the practical unfairness of it is all too clear.

To conclude, gentlemen, small businessmen like me are being killed by today's interest rates. Bankruptcies by small businesses are spreading like wildfire all across the country. This project, for example, is being forced on me by the Government, yet OMB is disobeying an explicit law passed by Congress to help small businesses comply with the Government's requirements. To top it all off, the Treasury is now after industrial revenue bonds in general. This is the only way for small businesses today to expand their production and improve productivity, and the administration is attacking this program despite the highest real interest rates and the biggest big business giveaways in history. That is hard for a small businessman to understand. Thank you.

Mr. BEDELL. Thank you very much for an excellent statement.

Mr. Durkin.

TESTIMONY OF EDWARD P. DURKIN, ADVANCE PLATING CO., CLEVELAND, OHIO

Mr. DURKIN. Mr. Chairman and members of the committee, the National Association of Metal Finishers [NAMF] appreciates the opportunity to offer testimony concerning the pollution control financing guarantee program administered by the Small Business Administration. This is a program that has greatly assisted the metal finishing industry.

I am Edward P. Durkin, president of Advance Plating Co., Cleveland, Ohio. I have previously served as president of NAMF, chairman of the association's pollution abatement committee, and I am actively involved with the Ohio Association of Metal Finishers.

My company, Advance Plating Co., is located in the inner city area of Cleveland. At the present time we employ 70 people, down from our last 2-year average of 100 employees. This year, 1982, is the 50th anniversary of Advance Plating. We do decorative plating, rustproofing, and painting for the automotive, appliance, and plumbing industries; we also do some defense work.

NAMF represents an industry which comprises over 9,000 job shop metal finishing firms across the country. We are, in the truest sense, an industry of small business. A typical electroplating firm employs 15 to 20 people and is capitalized at about $250,000. Generally speaking, our association members experience only modest returns on their investments due, in part, to the competitiveness of the small, independent metal finishers, and the presence of the large so-called captive shops that finish their own products.

Metal finishing is a vital part of this country's manufacturing economy. Essentially every manufactured product, ranging from automotive and aerospace goods, to surgical instruments and printed circuits for computer technology, are coated. Metal finishing results in a much safer and more efficient product. It also produces tremendous economic savings for the consumer by extending the life of the products and reducing maintenance and/or replacement costs.

NAMF is in a unique position to comment on the SBA's pollution control financing program. Our industry has been in the forefront of activities involving Federal water pollution control requirements. More specifically, metal finishing is one of the first industries for which EPA has developed pretreatment standards. These regulations would require that by January 28, 1984, electroplating job shops must have the required technology on line and operating. NAMF believes these regulations are technologically, environmentally, and economically unsound. Our association is actively involved in trying to remedy the problems created by the regulations, but it is not my intent to consume the committee's time with those details.

More relevant to this committee's interest is the fact that whether pretreatment is required by the Federal Government or through local programs developed by publicly owned treatment works, POTWs, which, by the way, NAMF strongly favors, the metal finishing industry will need considerable financial assistance.

Based on conservative estimates by the Environmental Protection Agency, the regulations would cost our industry over $1 billion in capital, over $490 million annually in operating expenses, and would result in the closure of about 20 percent of the metal finishing facilities in this country.

Needless to say, this is a staggering economic burden for our industry to bear, particularly when environmentally-sound treatment alternatives exist. I should point out that EPA, when it issued its regulations, estimated this closure rate could be reduced if adequate SBA loan and other financial assistance was made available.

The following is taken from EPA's regulations, and I quote:

The projected economic impacts of these standards are a major concern to the agency. The potential adverse effects of this regulation can be substantially reduced through the use of Small Business Administration Economic Injury Loans. The agency has been working with the Small Business Administration to insure that loans and other financial assistance programs will be available to eligible firms affected by these standards.

Unfortunately, as we understand it, the funding level of all SBA programs, including financing guarantees, are being reduced, and restrictions are being placed on the eligibility of certain guarantees. This is particularly disturbing since the guarantee program has not cost the Federal Government any money and, in fact, has enabled many businesses to continue operating and contributing to the economy. It is very difficult for me to understand how the economy is benefited if these businesses are not able to continue operating, which will be the case in the absence of some form of financial assistance.

Small businesses have a serious problem obtaining the necessary financing to cover the high cost of purchasing and operating pollution control equipment. Access to public and private markets for this type of assistance is usually not available. SBA's pollution control financing guarantee program has been one of the few tools that our members have been able to use. While we do not have the database to establish exact figures, we do know a significant percentage of the program's resources have gone to the metal finishing industry. It is one of the few Federal programs responsive to the needs of small business confronted with Federal, State and/or local environmental regulatory requirements. The following discussion of our efforts in Cleveland to solve our problems is a good example.

A recently completed study by EPA identifies Cleveland as the logical site to pursue the concept of centralized waste treatment, which has been successful in Europe and Japan. During the study, and right now, all interested parties—that is local industry, local and State government, and all regulatory agencies—have cooperated and endorsed this program without exception. We in Cleveland are ready to make not only centralized waste treatment a reality, but the further advantage of resource recovery a part of this plan. Unless we can find some type of reasonable financing, this project will not happen.

As the metal finishing industry endeavors to comply with the pretreatment requirements, regardless of which governmental level they emanate from, much of the industry simply will not be able to comply without programs such as SBA's pollution control financing guarantees. Metal finishers will be required to borrow amounts equal to their present capital in order to finance their purchase of pollution abatement systems needed for pretreatment compliance. As I mentioned earlier, without some form of governmental assistance, private institutions are unlikely to provide the necessary capital. This problem becomes even more acute when viewed in conjunction with other waste disposal program requirements such as those in the Resource Conservation and Recovery Act.

Mr. Chairman, we vitally need the type of Federal assistance offered by the SBA's pollution control financing program and I can assure you that the need will only intensify as more and more busi-

nesses attempt to meet the necessary environmental requirements. We appreciate this opportunity to explain our involvement with the program, and hope our views have been useful to the committee. I will be happy to answer any questions.

Thank you.

Mr. BEDELL. Thank you very much, Mr. Durkin.

I am sorry since many of the subcommittee members had other meetings they had to attend were not here because this certainly has been very beneficial testimony we have had from you people.

Mr. Schaefer, you talked some about the S-1 registration. Is that the registration you are going to need in order to get taxable bond financing?

Mr. SCHAEFER. That is what we have been told by our bond counsel and by our underwriter, yes, because apparently you do not need that kind of thing for an exempt issue because of Government backing, but you do for a taxable issue.

Mr. BEDELL. How much money are we talking about?

Mr. SCHAEFER. If audited financial statements are available for a company, if they have had fully audited financial statements back for 5 years, then the cost is somewhere between $50,000 and $75,000.

Mr. BEDELL. With a Government guarantee, would it not be possible to go to commercial lending institutions and get that money without having to go through all this registration?

Mr. SCHAEFER. Well, the problem is that a commercial lending institution will not lend you money for 20 years, and that is the term that has been alluded to earlier. The length of the financing is probably as attractive and as necessary as is the interest rate.

Mr. BEDELL. So, the only way you can get the long-term loans that you would need for this sort of thing is through bonding and through that bonding, you would need this difficult registration, if you were not to go the tax-exempt route. Is that what you are saying?

Mr. SCHAEFER. That is correct. Yes, an S-1 registration is a very common thing and if someone is going to have a public issue of stock or whatever, it is just very expensive, and they are very time-consuming.

Mr. BEDELL. Well, certainly, your testimony is very helpful.

Mr. Durkin, it is pretty good of you, I think, to dig up what EPA had originally said regarding the Small Business Administration economic injury loans. Apparently, those loans have been canceled by the administration now, so the only alternative——

Were those low-interest loans that we were talking about?

Mr. DURKIN. Yes.

Mr. BEDELL. So, the only possibility we have now is the tax-exempt bonds, and those tax-exempt bonds do not adversely affect the budget because they are obviously off-budget with this SBA loan guarantee and, apparently, from testimony we have had, not only that but they actually have made money for the Government because the guarantee fee is bigger than the losses.

Mr. DURKIN. Well, we as an industry have always objected to the EPA, at the bottom of many, many pages of regulations, shunting the economic responsibility to the SBA by just one paragraph. You know, for our particular industry, they are going back 4 to 5 years,

and using economic projections which have changed dramatically. They still, you know, have not updated those costs but they say, well, to minimize economic impact, see the SBA. They have, in effect, pushed it over to another agency.

Mr. BEDELL. Just for my own curiosity, you indicated that your organization also questions the EPA regulations. Do they question the regulations in terms of what they are trying to accomplish, or do they question the way the EPA is going about accomplishing what they are doing?

Mr. DURKIN. There is no argument whatsoever in what they are trying to accomplish, but I have been coming down here since 1972, since the act was passed through Congress, and we have always been arguing with statisticians and not people that really know what it is all about. We feel the regulations are totally too stringent and unnecessary and not only our industry, but people who operate publicly on treatment works and other people who are knowledgeable about the industry. We would have been on stream a long time before this if we had been able to get some type of reasonable regulations earlier.

Mr. BEDELL. Well, we thank you folks very much for being here.

Mr. SCHAEFER. Thank you.

Mr. PATTERSON. Thank you.

Mr. DURKIN. Thank you.

Mr. BEDELL. Excuse me just a minute. The minority counsel has a question.

Mr. KULIKOWSKI. While we have Mr. Patterson here, I thought maybe we could take advantage of following up on something he testified about at the last hearing, which was the status of Revenue Ruling 81-216, which has blocked one of the major means of Small Business Administration's finance of pollution controls and I was wondering if maybe Mr. Patterson could tell us what the current status of that revenue ruling is?

Mr. PATTERSON. That is another impediment, Mr. Chairman, that we haven't discussed this morning, but as you know not only are they trying to cut down on the guarantees, but on the one hand OMB is doing that, and Treasury through the IRS is trying to stop pooling of all bonds. Of course, that is the very essence of what the SBA's program is all about, that is, to put together several bonds for small business.

We are trying to do that in many States without the SBA's guarantee, but with other forms of guarantees, to enable small companies who are doing nonpollution control, because many of the projects that we see are both—pollution control and some production equipment—and we are trying to get expansion money on long-term credit terms and reasonable interest rates for these small companies.

I think as Jack's testimony showed it is very difficult for a small company to get long-term capital, and the changes that are going on in the financial markets are making it more difficult by the day. The thrift institutions aren't lending to them long term and the commercial banks all want floating rates and short maturity. So, it has been very important to us in our entire economic development program of a magnitude that I won't go into here, but it is very, very large in our State, and the Treasury has come along and

reversed 10 years of prior rulings—very explicit rulings allowing these pools—and just suddenly on August 24 jumped in with reversal. But at least they were candid enough to say that they thought the prior administration was just plain wrong.

Now, along comes the Treasury's proposals to restrict all tax-exempt financing, including pollution control for small business, and they want to take away the accelerated depreciation schedules, if you use an industrial revenue bond. That is the major proposal in my opinion and that is the one they are really after. If they succeed in doing that then no one will use tax-exempt bonds because if you do use a bond, you won't be able to depreciate it and your big competitors will be depreciating, which has a major impact on their cashflow, which is the worst problem for small business.

So, we are really looking at a situation in which they have come down with these proposals. They are pushing them in every way they can, I gather, and they have said as a byline to this, well, if we get these restrictions, then we will rescind Ruling 81-216 and permit pools. So much for the legal basis on which it was reversed and issued in the beginning. That, of course, has nothing to do with the restrictions as to the overall use of tax-exempt financing.

We were just plain their hostage, and Congressman Conte has just been terrific, as has Congressman Mavroules, trying to get—and I know you have done some of the work on this—the Treasury just to put down in writing what their position is vis-a-vis the Dole-D'Amato amendment and the transitional ruling request which we had in there. So, I think all signs are they are just going to stay right with this position with a frozen marketplace until they get some overall restrictions.

Mr. KULIKOWSKI. Just one followup question, what has been the effect of their continuing resolution, specifically section 112, which prohibited enforcement of Revenue Ruling 81-216? What has been the effect of that?

Mr. PATTERSON. The effect of it has been almost giving the Treasury what it wanted, and then some, because they have been technically stayed by that continuing budget resolution from enforcing 81-216, but they have announced that as soon as the continuing budget resolution expires, which I believe is the end of this month, they are going to go back retroactively to August 24 and enforce 81-216. So, nobody in the interim can take any action that would contravene 81-216 because they are on notice that the Treasury and the IRS will go back, and hit them with it as of August 24. So, the continuing budget resolution has not achieved its full objective other than expressing the sense of Congress.

At the same time, they have gone one step further and where they had announced that for those transactions that were underway before August 24, because they issued this new ruling reversing prior practice without any notice. They just suddenly brought it down. Under great pressure they finally said they would allow some of the transactions that were underway before August 24 to go forward. So, we put a ruling request in for this grandfather exemption pursuant to their press release and procedures, and the continuing budget resolution passed, and they said, well, now, this prohibits us from even acting on the transitional rulings, which was, in my opinion, an absolutely outrageous position.

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Now, I don't know what they are going to say on April 1. They are not supposed to have been thinking about it for 3 or 4 months or so, but we don't know. We hope that they will, after the budget resolution expires—if it does—that language, then we hope that they will give us, at least, the transitional one so we will get an order.

Mr. BEDELL. If Mr. Conte or Mr. Mavroules have any ideas of anything this committee can do, the chairman would certainly be receptive to it. Thank you.

Mr. PATTERSON. Thank you for your help.

Mr. BEDELL. Our last witness is Douglas Jacobson of the Filmite Oil Corp. of Butler, Wis., representing the Independent Lubricant Manufacturers Association.

Will you introduce the people who are with you, Mr. Jacobson?

TESTIMONY OF DOUGLAS W. JACOBSON, VICE PRESIDENT, FILMMITE OIL CORP., BUTLER, WIS., REPRESENTING THE INDEPENDENT LUBRICANT MANUFACTURERS ASSOCIATION; ACCOMPANIED BY ELIZABETH WARWICK, EXECUTIVE DIRECTOR; AND JEFFREY LEITER, COUNSEL

Mr. JACOBSON. Yes. Thank you, Mr. Chairman.

My name is Douglas W. Jacobson. I am vice president of Filmite Oil Corp. of Butler, Wis. I am appearing before the subcommittee on behalf of the Independent Lubricant Manufacturers Association. Accompanying me is Elizabeth Warwick, ILMA's executive director, and Jeffrey Leiter of the law firm of Collier, Shannon, Rill & Scott, counsel to ILMA. ILMA thanks the subcommittee for this opportunity to present its views on the Small Business Administration's pollution control guarantee program.

ILMA is a nonprofit trade association composed of nearly 150 small, independent companies which blend, compound, and sell finished lubricating oils and greases. Independent lubricant manufacturers generally are privately-owned businesses which range in size from 10 to 300 employees. ILMA members are neither owned nor controlled by firms that produce virgin lubricant base stocks from the refining of crude oil.

ILMA member companies have prided themselves on their efficiencies in manufacturing high-quality motor oils, transmission fluids, industrial oils, greases, and other lubricants to meet the consumer's needs. ILMA members provide lubricants to a wide variety of users, including the automotive, industrial, construction, and agricultural industries in this country. ILMA members compete with one another, as well as with major oil companies and re-refiners in the sale of lubricant products. Industry surveys indicate that independent lubricant manufacturers account for 20 percent of all lubricants sold in the United States.

The SBA's pollution control financing program, which is the subject of today's hearing, has been highly effective in making financing available for the construction and development of pollution control equipment and facilities. ILMA members are very concerned, however, that the program, for all intents and purposes, has been eliminated. As the subcommittee is aware, the adminis-

tration has restricted the dollar amount of guarantees to be given by SBA.

Also, the Office of Management and Budget has issued a directive to SBA forbidding it from guaranteeing loans financed through the issuance of tax-exempt industrial revenue bonds. In our view, the original congressional authorization level for SBA's pollution control guarantees and SBA's authority to guarantee loans financed through tax-exempt IRBs should not be tampered with.

I can speak with firsthand knowledge that SBA's program works, because my company, the Filmite Oil Corp., is a beneficiary of that program. On December 2, 1981, Filmite closed on $1.25 million in financing from a tax-exempt IRB issue guaranteed by the SBA. Filmite's financing provides for a loan term of 20 years at an interest rate of 12.4 percent.

Filmite is using the loan proceeds in two ways: First, as is the case for most loans guaranteed under the SBA's pollution control financing program, Filmite is upgrading its pollution control equipment and facilities to meet Federal and State environmental laws and regulations.

We are subject to requirements for wastewater treatment and spill prevention control and countermeasure plans. But pollution control equipment and facilities to meet such requirements are expensive. Such equipment and facilities usually do not add to a firm's net income. Thus, small businesses are forced to obtain short-term, high-interest, conventional loans which severely affect their cash flow. Accordingly, some alternatives to private sector loans to finance pollution control equipment and facilities are necessary.

Second, and more significant, Filmite is using the loan proceeds to expand its business of recycling used oil. The increased recovery and reuse of used oils is a subject of keen interest to this subcommittee. ILMA testified before this subcommittee on February 11, 1982, that the potential savings from the increased recycling of used oils are significant. The recycling of used oils is in accord with national energy policy to reduce our country's dependence on imported petroleum through conservation measures.

Greater recovery and reuse of used oils also helps to preserve the environment because most used oils are currently disposed of through dumping or uncontrolled burning. Yet, as ILMA testified at February's hearings, the economic development of the re-refining and recycling industries have been hindered by financing barriers because the capital costs of these processes are so high.

Filmite has been in the business of manufacturing lubricating oils since 1928. In 1974, our firm entered the used oil recycling business by constructing a "closed-loop" recycling process. Closed-loop recycling is an arrangement Filmite has with its commercial and industrial accounts whereby it collects their used oil, cleans the used oil, restores it to its original condition and returns it to the customer for reuse. Closed-loop recycling eliminates a waste disposal problem and decreases the cost of lubricating oil supplies to our customers.

Filmite has attempted to satisfy the demand in our market area for recycling used oil. However, it became obvious to our company that a substantial capital investment in facilities was necessary if

we were to stay in the recycling business on a profitable basis. We faced the choice of either expanding and improving our facility, or getting out of the business entirely.

In early 1980, Filmite had discussions with the commercial bank it has been doing business with since 1928, as well as another commercial bank, regarding approximately $1 to $1.5 million in financing for this project. Incidentally, our company has always had an outstanding credit rating for a business of its size.

These discussions indicated, however, that the only possibility for conventional financing available to us would be short-term notes of 3 to 5 years at interest rates of from 1½ to 2 points over prime. Very few calculations are needed to see that the debt service on such a loan would have put us out of the business in a relatively short period of time. The return on investment in the recycling business would not come anywhere near supporting this type of debt service.

We had just about given up our expansion plans when we learned of SBA's pollution control financing program. Following initial discussions to determine our eligibility, we made a formal application which was accepted. Filmite had to pass extensive credit checks by the SBA, by the First Wisconsin Bank, which administered the program, and by our own commercial bank.

Filmite has used the loan proceeds from the tax-exempt IRB issue to purchase land and equipment for its closed-loop recycling process. Approximately 75 to 80 percent of the funds are being used to purchase complex, state-of-the-art processing equipment. The other 20 to 25 percent of the funds are being used for the purchase of land and buildings.

When the completed facility comes on stream in the fourth quarter of this year, Filmite will have increased its recycling capacity by about four times. When one considers that 60 to 70 gallons of crude oil must be refined to replace every gallon of lubricating oil that is disposed of, the impact of this new recycling capacity is significant.

Filmite's finished recycling facility will have complete control over all effluents and emissions. Its process does not produce the acid sludge associated with many antiquated processes, which had been the mainstay of the re-refining industry for years. Rather, all residue that is produced can be disposed of in environmentally acceptable landfills. There is no liquid disposal. Some residue actually may have commercial value.

Without the SBA-guaranteed financing, Filmite would have been forced to quit the recycling business. Instead, we will be expanding and we will be increasing our work force.

SBA's pollution control financing program has had an impact beyond this low-cost, long-term financing for our company. Our own customers depend upon the company to recycle their used oils. If our closed-loop arrangement did not exist, our customers would dump or burn their used oils. These problems are eliminated by recycling. In addition, the recycled oils we return to our customers represent a substantial cost savings, which help reduce, in turn, the cost of the products that they produce.

The greater recycling of used oils also can mitigate future, critical shortages of lubricants and can minimize possible interruptions

to essential economic activities, which cannot function properly without adequate lubricants. ILMA's testimony at the subcommittee's February hearing on used oil recovery highlighted forecasts of shortages in lubricant base stocks by the mideighties.

As I mentioned earlier, Filmite would not have undertaken an expansion of its used oil recycling business without SBA's pollution control financing program. Filmite is an example to this committee that numerous national policy considerations, as well as practical business concerns, are effectively addressed by the SBA program. The continued availability of the program to ILMA members and other small businesses would allow greater amounts of used oils to be recycled, thereby benefiting the environment and promoting energy conservation. The program permits a small business, such as Filmite, to provide additional jobs.

Mr. Chairman, if I may be permitted to make a brief personal aside before I conclude my remarks, I would like to share with you and the subcommittee my highest regard for the manner in which SBA's pollution control financing office is operated. The cost effectiveness of this program through the fees that it generates is certainly appealing to the taxpayer. Vincent Fragnito and his very small staff at SBA made the process of obtaining financing go extremely smoothly for us. SBA's pollution control financing office gave us quick answers and thorough assistance every step of the way. I cannot say enough about the competency of this office.

In summary, ILMA requests that the subcommittee take appropriate steps to prevent the gutting of SBA's pollution control financing program. ILMA is aware of the need to control Government deficits and to plug tax loopholes, but the curtailment, and essentially de facto elimination, of SBA's program does nothing to accomplish these goals. Rather, the emasculation of SBA's effective program is counterproductive to the country's attempts to restore economic health. ILMA appreciates this opportunity to express its views and I would be happy to respond to any questions that you might have.

Mr. BEDELL. Thank you very much, Mr. Jacobson. You talked about the need to control Government deficits. This program would appear to help control Government deficits. First of all, it is off budget, so those loans do not adversely affect the budget and, secondarily, as near as we can tell, the money that they take in in fees greatly exceeds any potential losses. So, it is one of the few profitable operations that we have.

Mr. JACOBSON. That is certainly true.

Mr. BEDELL. I think that I speak for both the minority and majority members of the committee in agreeing with you regarding the way that this particular office is handled, and Mr. Fragnito's management of this particular office, and it is not too common for this chairman to be making complimentary remarks, so we appreciate the fact that you have mentioned this as well.

Mr. JACOBSON. That is right.

Mr. BEDELL [continuing]. And, therefore, exemplify what can be done and the benefits of the program under those circumstances. Particularly in view of the fact that you already were successful in getting yours approved, the fact that you have come here to testify,

I think, speaks very well for you. Do either of the staff have any questions before we adjourn?

Mr. ROSENBERG. One short question that perhaps this witness can help us with. The main argument from the administration in opposition to tax-exempt financing seems to be that by denying access to the tax-exempt bonds, we are protecting the Government from the revenue loss of that tax exemption. I am wondering if, on behalf of your association or from your perspective as an individual businessman, you could shed some light on what happens when these tax-exempt bonds which the program guarantees are not available.

It would seem that we have some risk here that a company that is currently paying taxes and providing payroll and consequently generating additional income taxes and so forth may disappear if this kind of financing is not available, which would certainly greatly outweigh any potential revenue saving that we get by closing the tax-exempt bond option. Do you have any comments on that?

Mr. JACOBSON. Well, first of all, I guess I don't understand how eliminating this type of funding would increase revenues to the Federal Government. In Filmite's particular case, if the funding were not available, we would not have borrowed the money or issued the bonds. There would have been nothing for the Government to tax because nobody would have bought any bonds.

Second, in our particular case, if we would not have had this type of financing, we would have had to close down a significant portion of our business and lay off a substantial number of employees. So, not only would the Government have lost the payroll taxes from those employees, but they would have to compensate them through unemployment compensation for some period of time.

Third, this program involved our purchasing of quite extensive capital equipment, which is manufactured here in the United States. That also provided jobs for the vendors that are supplying all of the equipment. It also provided jobs for the electrical and mechanical contractors that are doing the work on the project.

So, the downstream effect of arbitrarily eliminating this type of financing would have a severe impact.

Mr. ROSENBERG. Thank you.

Mr. BEDELL. Thank you very much for your testimony.

Mr. JACOBSON. Thank you.

Mr. BEDELL. The subcommittee will be adjourned.

[Whereupon, at 11 a.m., the subcommittee adjourned, to reconvene subject to call of the Chair.]

POLLUTION CONTROL FINANCING FOR SMALL BUSINESSES (PART 2)

WEDNESDAY, MARCH 31, 1982

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON ENERGY, ENVIRONMENT, AND
SAFETY ISSUES AFFECTING SMALL BUSINESS,
COMMITTEE ON SMALL BUSINESS,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:13 a.m., in room B-352, Rayburn House Office Building, Hon. Berkley Bedell (chairman of the subcommittee) presiding.

OPENING STATEMENT OF CHAIRMAN BEDELL

Mr. BEDELL. The Subcommittee on Energy, Environment, and Safety Issues Affecting Small Business will come to order. This morning, the subcommittee holds its third and final hearing on pollution control financing for small businesses. I guess it's our final one, depending on what comes up.

Our only witness today is John Chapoton, Assistant Secretary of the Treasury for Tax Policy. Because of our oversight responsibilities, our hearings thus far have focused on the Small Business Administration's pollution control loan guarantee program.

I believe I speak for all of the members of this subcommittee when I say we're very concerned by the administration's repeated efforts to reduce or curtail this program even in the face of several specific acts of Congress to maintain the program as it was established by law. Our hearing record clearly shows that the SBA's pollution control loan guarantee program, which was created by Congress in 1976, has been a success. It has met its objective of providing small business with assistance in financing Government-mandated pollution control expenditures.

Perhaps equally important is the fact that this SBA program has been run very efficiently, actually making money for the Treasury.

It has established a record that other programs only aspire to.

With this in mind, the subcommittee was puzzled by recent administration actions that have had the effect of crippling the SBA's pollution control loan guarantee program.

At our first hearing on this subject, last November, we had the Associate Administrator of the SBA testifying. We asked him, if the SBA's pollution control loan guarantee program was not available, was there anywhere else in the Government where business could go to get help with its pollution control financing require-

ments. He replied, and I quote, "Well, there is really no alternative program that I am aware of to meet that need."

Witnesses at our previous hearings have clearly established that the decisions affecting this program were made outside of the SBA. Indeed, we were told by both the SBA and the Office of Management and Budget that decisions affecting this program were made in the broader context of the administration's overall policies regarding tax exempt financing and Government loan guarantees.

Consequently, we are pleased to have with us today the administration's spokesman on these issues. In particular, we look forward to exploring with him what happens when the generalities of the administration's broad policies are applied to the specifics of this particular program.

Mr. Conte, do you have a statement?

OPENING STATEMENT OF HON. SILVIO O. CONTE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MASSACHUSETTS

Mr. CONTE. Yes, Mr. Chairman. Certainly, this committee cannot be accused of shirking its duties or not being thorough. Pollution control bond guarantees have gained the limelight, if not a following. I wish it were clear that we were here to praise the program and not to bury it.

The whole subcommittee was present when we voted unanimously to invite a spokesman from the administration to set the record straight once and for all. We've had small business after small business make their treks to Washington, to tell us the recent policy changes in this program are indefensible. SBA has testified that it has only been following orders. So today it is our chance to hear the other side of the story, and to deliberate on the proper course to take.

As I understand it, there are three issues. First is the OMB's orders to SBA in late December not to guarantee tax exempt pollution control bonds. This one stroke wreaked havoc on 128 applications involving $129 million in pollution control equipment already in the pipeline. Since that order, zero guarantees to my knowledge have been approved.

The second issue goes back to our discussion in November concerning the importance of the small issue industrial development bonds to the way small businesses have packaged their pollution control financing.

As we all know, the Revenue Ruling 81-216 has pretty much put a stop to that method. To set the record straight, I will report that on Monday I did receive an answer from Mr. Chapoton to my letters of January 11 and February 11 asking for Treasury's official interpretation of section 112 of the continuing resolution as it relates to Revenue Ruling 81-216.

And, third, there is the administration's proposal with regard to reforming the small issue IDB. I know it would be helpful to me to hear a brief explanation of how those proposals would affect small business pollution control financing. I would like to commend the chairman for taking such a strong interest in the pollution control

program, and I would also like to thank Mr. Chapoton for honoring the subcommittee's invitation so promptly.

Thank you, Mr. Chairman.

Mr. BEDELL. Mr. Chapoton, we would like to hear your testimony.

TESTIMONY OF HON. JOHN E. CHAPOTON, ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF THE TREASURY

Mr. CHAPOTON. Thank you, Mr. Chairman. I'm here today to discuss the views of the Treasury Department on guarantees by the Small Business Administration of tax-exempt industrial development bonds issued to the finance pollution control facilities.

As I believe you know, the Treasury Department opposes the SBA guarantees of tax-exempt pollution control obligations. In addition, the administration is now proposing that Congress enact restrictions for all types of private purpose tax-exempt bonds. Therefore, before commenting upon our particular concerns with respect to pollution control obligations and the SBA program, I would like to review some of the factors that have caused us to conclude that additional limits are needed on all types of private purpose tax-exempt bonds.

There has been a virtual explosion in the last 5 or 6 years in the issuance of private purpose tax-exempt obligations. This includes bonds issued for single family housing, student loans, and nonprofit hospitals and colleges as well as industrial development bonds.

More than $25 billion of private purpose tax-exempt bonds were issued in 1981, up from $8.5 billion in 1976. Private purpose bonds accounted for 24 percent of the long-term tax-exempt bond market in 1976, but it rose to 48 percent in 1981.

We estimate that 55 percent of the tax-exempt bonds sold in 1982 will be used for private activities. The volume of pollution control obligations issued for private businesses was $3.8 billion in 1981, representing approximately 7 percent of the entire tax-exempt market, and will be an estimated $4.2 billion in 1982.

The largest growth in private purpose bonds has come about in the small issue IDB area. Those rules allow virtually any business to obtain tax-exempt financing for land or depreciable property. Small issue IDB's have been used extensively by the largest corporations in the country. For example, one of the largest retailing chains has used small issue IDB's to finance $240 million of facilities since 1976. Small issue IDB's marketed in 1981 were an estimated $10.5 billion of the total of $25 billion of private purpose bonds. Small issues represented 20 percent of the entire long-term tax-exempt market in 1981, compared with only 4 percent of the tax-exempt market in 1976. We estimate that the revenue loss from small issue IDB's will be $1.6 billion in 1982, and will exceed $2.1 billion in fiscal 1983 unless additional restrictions are imposed. Moreover, we estimate that less than 15 percent of the new investments made in 1981 that were eligible for small issue IDB financing were in fact financed by that method. This means that the potential for future growth in the volume of small issue IDB's remains enormous.

Proliferation of private purpose tax-exempt bonds, along with reduced demand for tax-exempt bonds by institutional investors and

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the tax rate reductions, and other structural tax changes enacted in the Economic Recovery Tax Act of last year, has contributed to a significant narrowing of the difference in interest rates between tax-exempt and taxable bonds.

The tax-exempt rate has been historically 65 to 75 percent of the taxable rate, but issuers of tax-exempt bonds currently have to pay about 80 to 85 percent of the taxable income rate. This erosion of the relative advantage of tax-exempt financing has increased significantly the interest costs incurred by State and local governments in financing essential public services and facilities.

Increasing the volume of private purpose tax-exempt bonds has also caused mounting Federal revenue losses. We estimate that the total Federal revenue loss from private purpose tax-exempt bonds outstanding as of this time, in fiscal 1981, was $3.2 billion and will be almost $4.2 billion in fiscal 1982.

Proliferation of tax-exempt bonds has made them less cost effective as subsidy mechanisms for private activities. Tax-exempt financing has often been criticized as an inefficient means of granting Federal subsidies. The revenue loss to the Treasury from the income tax exemption is significantly greater than the interest cost savings to the users of the bonds. For example, if we assume that the investor is in a 40-percent bracket and purchases a bond bearing interest cost at 70 percent of the taxable rate, the Treasury loses $1.33 for every dollar of savings in interest to the bond user. Even more of the benefit is siphoned off by investors as tax-exempt bond rates grow closer to taxable rates—as they recently have—and if you assume that the buyer is in a higher than 40 percent income tax bracket.

These and other considerations have caused us to conclude that additional restrictions are needed to reduce the growth of private purpose tax exempt obligations. Specific details about the proposals were released on February 26, and I have submitted copies of both the general and technical explanations of our proposals to you for insertion into the record, Mr. Chairman.

The specific provision for small business under our proposal relating to small issue IDB's should be of particular interest to this subcommittee. Under the administration's proposal, small issue IDB's will be retained for businesses that have capital expenditures of less than $20 million over the 6-year period from 3 years before to 3 years after the issuance of the bonds. In addition, no single firm will be able to have over $10 million of IDB-financed facilities at any one time. However, subject to these restrictions, small issue IDB's could be marketed as part of a composite or an umbrella bond issue. These changes will make it easier for small- and medium-sized businesses to use small issue IDB's and will prevent the use of small issue IDB's by large corporations that are able to raise funds readily in capital markets without an interest subsidy from the Federal Government.

I'd now like to discuss the policy considerations relating specifically to tax-exempt financing for pollution control facilities and the SBA guarantee program.

It is often argued that Federal assistance for construction of pollution control facilities is justified because pollution control requirements are special burdens imposed on businesses by Govern-

ment. However, in our view, the cost of controlling pollution should be regarded as part of the cost of producing goods and should be reflected in market prices. The consumption of goods produced by techniques that create air or water pollution as a by-product will be excessive if the market prices of those goods are not reflective of all production costs. Thus, providing tax-exempt financing for investments in pollution control facilities produces undesirable economic distortions, in that it results in a higher level of investment in polluting industries, and a lower level of investment in other economic activities.

Another result of the subsidy is that part of the cost of controlling pollution is borne by taxpayers in general, rather than purchasers of the goods produced.

Tax-exempt financing for pollution control facilities also has been justified in the past by the need to assist businesses in bringing existing plants into compliance with new pollution control requirements. Now, however, most pollution control bonds are issued to finance pollution control facilities for new plants rather than existing facilities. Thus, the "transition rule" argument for the tax exemption is no longer applicable in a majority of the cases.

Furthermore, it is difficult in many cases to determine what portion of a newly constructed plant constitutes pollution control facilities, particularly if the plant employs new or innovative processes or equipment rather than facilities of a type that have previously been recognized as qualifying for tax-exempt financing. This inevitably creates an undesirable bias against new technology and in favor of particular types of pollution control equipment which are recognized as eligible for tax-exempt financing.

Providing Federal guarantees for tax-exempt obligations raises additional problems. Placing the credit of the United States behind an obligation that is exempt from Federal taxation creates a security which is superior in the market to the direct obligations issued by the Federal Government. A federally guaranteed tax-exempt obligation also has a distinct competitive advantage over all other tax-exempt obligations issued by State and local governments. As a result, Federal guarantees of tax-exempt obligations increase the borrowing costs of Federal, State, and local governments.

Because of these and other considerations, the Treasury Department has consistently opposed Federal guarantees of tax-exempt obligations. Moreover, the Public Debt Act of 1941 prohibits the Federal Government from issuing tax-exempt obligations directly, and numerous other statutes preclude Federal guarantees of tax-exempts in other contexts. Allowing SBA guarantees of tax-exempt pollution control obligations would be directly contrary to the policies expressed by Congress in those enactments.

Finally, in these times of budgetary constraint, we believe that the SBA guarantees of tax-exempt obligations would represent an unwarranted duplication of Federal benefits. Both the SBA guarantee and the income tax exemption are implicit subsidies that reduce the interest that the borrowers must pay. In view of the pressures on the tax-exempt bond market and inherent inefficiencies involved when using tax-exempt financing as a subsidy mechanism, we believe that it is appropriate for the Small Business Ad-

ministration to restrict its guarantee program to taxable financings.

Mr. Chairman, that concludes my remarks. I will be happy to answer any questions.

Mr. BEDELL. Thank you, Mr. Chapoton. Without objection, the general and technical explanations of your department proposals will be inserted into the record at this point.

[The material referred to above follows:]

TAX-EXEMPT BONDS FOR PRIVATE ACTIVITIES

General Explanation

Current Law

The interest on State and local bonds issued for private activities is generally taxable, with certain exceptions enumerated in the Code. The exceptions include three general categories of tax-exempt revenue bonds for private purposes: 1) industrial development bonds that qualify as exempt small issues; 2) industrial development bonds issued to finance certain exempt activities; and 3) certain other private purpose revenue bonds. A State or local government obligation is an industrial development bond (IDB) if all or a major portion of its proceeds are to be used in the trade or business of a non-exempt person (that is, a person other than a State or local governmental unit or an organization exempt from tax under section 501(c)(3) of the Code) and the obligation is secured by or is to be repaid from trade or business property or receipts.

Exempt Small Issues: Exempt small issue IDB's can be issued in amounts of $1 million or less for the acquisition, construction or improvement of land or depreciable property located in any one city or county. The $1 million limitation can be increased to $10 million at the election of the governmental issuer provided the aggregate amount of exempt small issues outstanding and capital expenditures (other than those financed with exempt small issues) of the business in the particular jurisdiction do not exceed $10 million over a 6-year period. Current law imposes no restrictions on the type or location of business activities that may be financed with exempt small issues.

Industrial Revenue Bonds For Exempt Activities: Current law also provides an income tax exemption for interest on bonds used to finance certain specific "exempt activities." Some of these bonds are used to provide quasi-public facilities such as airports and mass commuting facilities, but others are used for strictly private purposes such as industrial parks and pollution control facilities. No limitation exists on the amount of these obligations or the locations in which they may be used.

Other Private Purpose Revenue Bonds: Specific statutory exemptions currently allow tax-exempt financing for student loans and for organizations that qualify for tax exemption under section 501(c)(3). The principal section 501(c)(3) organizations that use tax-exempt financing are private non-profit hospitals and private non-profit educational institutions. In addition, mortgage revenue bonds to finance

certain owner-occupied housing are eligible for tax-exempt financing through 1983.

Reasons for Change

The volume of tax-exempt bonds issued for non-governmental users has grown rapidly during the past five years. The largest growth has occurred in small issue IDB's, which allow access to tax-exempt financing for any type of trade or business. Continued growth in the use of tax-exempt bonds for private purposes is expected unless actions are taken to limit their use. The expansion of tax-exempt bonds for private purposes affects the market for tax-exempt securities as a whole, raising the cost of State and local governments of financing traditional public services.

Many of the private activities using tax-exempt financing would not have received direct Federal or local government assistance. Access to tax-exempt financing is offered in almost all political jurisdictions, either by State or local governments or by authorities acting on their behalf. These authorities are often established for the sole purpose of issuing tax-exempt revenue bonds for private entities and generally serve as mechanisms for avoiding local voter approval requirements.

Providing tax exemption for the interest on certain private purpose obligations may serve legitimate public purposes in some instances. Current law, however, does not require the showing of any genuine public purpose for the project to be financed with tax-exempt obligations. A requirement that private purpose tax-exempt obligations be shown to serve the needs of the local community would improve the uses of the Federal tax benefit and would limit the volume of such obligations, thus reducing their impact on the market for traditional municipal bonds and on the Federal government's revenue loss.

Tax exemption of interest on bonds issued by State or local governments is an important element of the Federal system of government. However, State and local governments have in many cases become merely conduits through which private parties gain access to the tax-exempt bond market. In addition, some local issuing authorities have profited from their ability to pass on the tax exemption by obtaining fees for authorizing bonds for facilities located outside of their own jurisdictions. Private purpose tax-exempt obligations have also been used to obtain substantial arbitrage profits on reserve funds and funds held during temporary construction periods.

The availability of tax-exempt financing for exempt activities and other private purposes causes distortions in the allocation of scarce capital resources. The ability to

obtain a lower cost of borrowing for certain activities, for example, businesses requiring pollution control facilities, through the use of tax-exempt financing creates a bias in favor of investment in those activities. In effect, those favored activities, for example, businesses that create pollution, are subsidized at the expense of other activities. Thus, the allocation of capital investments is based upon government decisions rather than their relative economic productivity. Moreover, in combination with the Accelerated Cost Recovery System (ACRS) provided by the Economic Recovery Tax Act, tax-exempt financing can result in a substantial negative tax or subsidy for qualifying activities. Presently, eligible activities are able to add the tax benefits from IDB's to the tax benefits from ACRS. Permitting tax-exempt financing for private investments that also qualify for ACRS would allow companies to borrow at tax-exempt interest rates for investments that provide generally tax-free income. Those companies could then deduct the tax-exempt interest to shelter income from their other assets.

In contrast with other categories of private purpose tax-exempt bonds, exempt small issues may be used in limited dollar amounts for any type of investment in depreciable property or land. Large businesses presently are able to finance numerous facilities nationwide with small-issue IDB's because the dollar limit applies only to a single city or county. Many large firms are using small issue IDB's even though they are able to raise funds readily in capital markets without a government subsidy or guarantee.

Proposal

The proposal limits tax exemption for private purpose obligations currently eligible under section 103 to those issued under the following conditions:

(1) The highest elected official or legislative body, for example, the mayor or city council, of the governmental unit issuing the bonds and in which the facility is located must approve the bonds after a public hearing. Alternatively, the public approval requirement could be met by a voter referendum on the bonds to be issued for the particular facility.

(2) In the case of bonds issued after December 31, 1985, the governmental unit must make a contribution or commitment to the facility financed with tax-exempt bonds. The contribution could take the form of a cash payment, tax credit or abatement, provision of additional services, or payment of the bond issuance expenses with a value on the date the bonds are issued equal to one percent of the face amount of the bonds. Alternatively, the issuing governmental

unit can satisfy the commitment requirement by insuring or guaranteeing the bonds or by designating the bonds as general obligations of the State or local government.

(3) The costs of depreciable assets financed with tax-exempt bonds must be recovered using straight-line depreciation over the extended recovery period used for earnings and profits computation purposes.

(4) Exempt small issue IDB's will be limited to small businesses. A small business is defined as a business that has capital expenditures of less than $20 million over a six-year period. In addition, bonds would not qualify as exempt small issue IDB's if the business will have more than $10 million of IDB's outstanding after issuance of the bonds.

(5) With these restrictions, small issue IDB's could be sold as a part of a composite or umbrella issue of bonds.

(6) Each bond must be in registered form and information concerning the issuance of the obligations must be reported by the State or local government to the Internal Revenue Service.

(7) Restrictions on the investment yield from the use of the proceeds of the obligations are extended to reserve funds and funds held during the temporary construction period. Bond costs may not be taken into account in determining the yield for purposes of the arbitrage limitations.

(8) Except as indicated above with respect to the financial contribution or commitment requirement, the additional restrictions generally apply to private purpose bonds issued after December 31, 1982. However, the restrictions will not apply to single-family mortgage subsidy bonds issued before January 1, 1984, since such bonds after 1983 will be denied tax-exempt status.

Effects of Proposal

The proposal will impose needed limitations on access to the tax-exempt market for private activities. The volume of tax-exempt financing for private purposes has grown enormously during the past five years. New issues of private purpose tax-exempt bonds rose from $8.5 billion in 1976 to over $25 billion in 1981, as shown in the following table. The dollar volume of private purpose bonds increased at an annual rate of 25 percent between 1976 and 1981, while public

purpose bond volume rose at a 1 percent annual rate during the same period. Private purpose bonds accounted for 48 percent of the tax-exempt bond market in 1981 compared with only 24 percent in 1976.

Growth in Private Purpose Tax-Exempt Financing
1976 to 1981

	Volume of Tax-Exempt New Issues ($ billions)		Annual Rate of Growth Between 1976 & 1981 (In Percent)
	1976	1981	
Housing	$3.0	$6.9	18%
Private Hospitals	1.9	3.5	13
Student Loans	0.1	1.0	58
Pollution Control	2.1	3.8	13
Small Issue IDB's	1.4	10.5	50
Total	8.5	25.7	25

The reduction in private purpose tax-exempt bonds will help restore the benefit of tax-exempt financing for traditional governmental purposes and will reduce the growing Federal revenue loss attributable to the increasing volume of private purpose tax-exempt obligations. The benefit from tax-exempt financing to borrowers has traditionally been a savings of 30-35 percent of the taxable interest rate. The benefit from tax-exempt financing has fallen to 15-20 percent of the taxable rate on 20-year obligations in 1981, due in large part to the high volume of private purpose tax-exempt bonds. Lowering the volume of private purpose tax-exempt bonds will reduce the interest rates necessary to attract funds to the tax-exempt market.

The proposal requires business users to choose between the benefits of tax-exempt financing and the tax savings from accelerated depreciation allowances. The result is to make the after-tax cost of capital for businesses using ACRS without tax-exempt financing nearly equal to the cost for those using IDB financing. For example, a firm choosing to finance a plant with IDB's after the proposal will have tax benefits equal to 23-29 percent of each dollar invested compared with 26 percent without IDB's. Similarly, for firms financing equipment (5-year ACRS recovery property), the tax savings per dollar invested will be 48-54 percent with IDB's after the proposal compared with 49 percent without IDB's. Without the proposal the combination of tax-exempt financing, ACRS, and the investment tax credit for equipment results in tax savings of 61-67 percent per dollar invested, which offsets not only the future income tax attributable to the equipment, but also the tax on income from other investments.

These restrictions on the use of tax-exempt bonds by private entities are consistent with the goals of the Economic Recovery Tax Act. ACRS provides tax incentives similar to tax-exempt financing, but does so for all capital investments, not just a select group. ACRS is, therefore, an appropriate substitute for tax-exempt financing.

Subject to the additional restrictions on IDB's generally and small issue IDB's in particular, small issue IDB's would be allowed to be sold as a part of a composite or umbrella issue of bonds. When these bonds are limited to small companies, it is appropriate to permit the marketing of packages of these issues to reduce transaction costs and to provide a degree of diversification that may decrease the risk premiums demanded by investors.

Revenue Estimate

Fiscal Years					
1982	1983	1984	1985	1986	1987
($ billions)					
--	-0.2	0.3	1.1	2.1	3.2

TAX-EXEMPT BONDS FOR PRIVATE ACTIVITIES

Technical Explanation

Summary of the Proposal

To insure that tax-exempt obligations issued for private activities serve valid public purposes, the obligations must be approved, after a public hearing by the highest elected official or legislative body of the jurisdiction in which the project is to be located or by a voter referendum.

For bonds issued after December 31, 1985, the governmental unit must make a financial contribution or commitment to the project. The contribution may be a direct grant, tax abatement, or provision of additional services having a value of at least one percent of the face amount of the bonds. The financial commitment may take the form of a general obligation of the governmental unit, or primary guarantee or insurance of the bonds.

Depreciable assets financed with tax-exempt bonds must be written off using the straight-line method over the extended cost recovery period used for computing earnings and profits.

Small issue IDB's will be limited to small businesses that have no more than $20 million of capital expenditures during a six-year period and have no more than $10 million of industrial development bonds outstanding immediately after the issue.

The bonds must be in registered form and information must be reported to the Internal Revenue Service upon the issuance of the bonds.

Restrictions will be placed on the ability of issuers to earn arbitrage profits.

Except as otherwise indicated above, the additional requirements generally would apply to bonds issued after December 31, 1982.

Detailed Description

The proposal imposes four additional requirements on State and local governments issuing tax-exempt bonds for private purposes. Private purpose tax-exempt bonds subject to these requirements include industrial development bonds (section 103(b)(2)); qualified scholarship funding bonds (section 103(a)(2)); and bonds issued for use in a trade or business by section 501(c)(3) organizations (section 103(b)(3)(B)). A fifth requirement prohibiting "double

dipping" of tax benefits will apply to all industrial development bonds. A sixth requirement limits small-issue IDB's to small businesses. Mortgage subsidy bonds (section 103A) issued before January 1, 1984 (the "sunset" date for such bonds), are not subject to these requirements.

The first additional requirement is that the bond issue must be approved by the highest elected official or legislative body of the governmental unit by or on whose behalf the bonds are issued and in which the project financed by the bonds is to be located (or in which the eligible sellers of student loan notes are located, in the case of qualified scholarship funding bonds). To satisfy this requirement, bonds issued by or on behalf of a state could be approved by the governor or the State legislature; and bonds issued by or on behalf of a city could be approved by the mayor or the elected city council. As an alternative, the public approval requirement could be met by a voter referendum on the bonds to be issued for the particular project. Any bonds issued by or on behalf of more than one governmental unit must be approved by each governmental unit involved. The public approval requirement would be an additional requirement of the Federal tax law and would not affect the procedures used to approve bonds under applicable local law.

Prior to approval of a bond issue, a public hearing must be held to give members of the public the opportunity to comment upon the proposed bond issuance. Notice of the public hearing must be given prior to the date the public hearing is held. Similarly, notice must be given to the public promptly after the approval of the bonds. Generally, the notice would be sufficient if given in the same manner as required for other legal purposes, for example, by advertising in local newspapers. Both the notice of the public hearing and the notice of approval of the bond issue must describe the facility or activity to be financed by the bond issue and must specifically state the public purpose or purposes that will be served.

The second additional requirement is that the governmental unit issuing the bonds must make a financial contribution or commitment to the project. This requirement will apply to bonds issued after December 31, 1985. A contribution to the facility or project must have a present value equal to one percent of the face amount of the bond. The contribution can take the form of a cash payment, tax credit or abatement, provision of additional services, or payment of bond issuance expenses. The present value of scheduled future contributions to the facility or project must be determined by discounting the future contributions by the yield on the bonds. The contribution must be specifically earmarked for the facility or project and must be approved by the elected official or legislative body that

approves the bond issue. General tax reductions or regular services provided to all facilities are not counted for this purpose. However, general tax exemptions provided for exempt organizations under State law could be used to satisfy the contribution requirement with respect to projects for exempt organizations. The governmental unit may not be reimbursed by the user of the facility for any contribution used to satisfy this requirement.

As an alternative means of satisfying the second additional requirement, the issuing governmental unit can make a financial commitment to the project in either of two ways. The financial commitment requirement could be satisfied if the bonds issued are general obligation bonds of the State or local government, or if the State or local government assumes responsibility as the primary insurer or guarantor of the bonds.

The third additional requirement is that the bonds must be in registered form and the issuance of the obligations must be reported by the State or local government to the Internal Revenue Service.

The fourth requirement is related to the unlimited yields issuers presently can earn on private purpose tax-exempt bond proceeds during the temporary construction period and on reserve funds (section 103(c)(4)). The proposal eliminates the exceptions for the temporary construction period and reserve funds for determining whether the bonds are arbitrage bonds. The yield calculation for arbitrage limitation purposes cannot take bond issuance costs into account.

A limitation applying to all industrial development bonds (section 103(b)(2)) is that the costs of depreciable assets financed with tax-exempt IDB's must be recovered using the straight-line method over extended earnings and profit recovery periods (section 312(k), as amended by Section 206 of the Economic Recovery Tax Act of 1981). Assets will not qualify for treatment under the Accelerated Cost Recovery System (ACRS) if they are subject to IDB financing when placed in service by the taxpayer even though the IDB financing was originally obtained by another person or is subsequently paid off. Assets qualifying for the investment tax credit under present law (section 38) will remain eligible for the credit even though they are financed with tax-exempt bonds. The depreciation allowance for any asset financed with tax-exempt IDB's shall be the amount determined under the straight-line method (using a half-year convention in the case of property other than the 15-year real property, and without regard to salvage value), using the following recovery periods:

ACRS Classification	Straight-Line Recovery Period if IDB Financed
3-year property	5 years
5-year property	12 years
10-year property	25 years
15-year real property	35 years
15-year public utility property	35 years

For depreciable assets that are not completely financed with IDB's the denial of ACRS will apply only to the portion financed with tax-exempt debt. Special rules will be provided for determining which assets are deemed to be financed with IDB's.

The final limitation on private purpose tax-exempt bonds restricts the use of small issue IDB's (section 103(b)(6)) to small businesses, defined as those with capital expenditures of less than $20 million during the period from three years before through three years after the issuance of the bonds. In addition, bonds will not qualify as exempt small issue IDB's if the business would have more than $10 million of industrial development bonds outstanding immediately after the sale of the bonds (excluding any previously issued bonds redeemed with the proceeds of the bonds in question). The $1 million and $10 million limitations of existing law will continue to be applicable, except that bonds will not be disqualified solely because they are sold as a part of a composite or umbrella issue of bonds.

Effective Date

Except as otherwise noted with respect to the financial contribution or commitment requirement, these provisions will apply to all private purpose bonds issued after December 31, 1982, including refunding bonds. However, the provisions will not apply to single-family mortgage subsidy bonds issued before January 1, 1984, since such bonds after 1983 will be denied tax-exempt status.

Mr. BEDELL. Before we proceed with Mr. Conte, did you have any statement, Mr. Hiler, that you wished to make?

Mr. HILER. No.

Mr. BEDELL. Mr. Conte.

Mr. CONTE. That was a good statement, but somehow I disagree with it. The Federal Government in the last decade passes all these EPA laws, and they force these down the throats of the small businessman. He doesn't have the liquidity of big business, and we tell him that he's got to put in pollution control systems. He goes ahead and does it. Why shouldn't the Government try to help him?

Mr. CHAPOTON. Well, Mr. Conte, I've been involved in pollution control facilities and financing of pollution control facilities for a long time. It is, as I know, particularly irritating to both small and large businesses when they see tremendous amounts of capital required for nonproductive assets. So the Congress responded in the late sixties and early seventies both with tax-exempt financing and in other ways—for example, faster writeoffs for the equipment. It is easy to understand why there was sympathy and why the Congress responded.

We had an extra problem then that I think, for the most part, doesn't exist now, and that was that we were talking about retrofit. But we have to recognize that if we decide that pollution costs should be taken into account in a product, then it is simply not economically sound in our view, nor is it probably fair to mislead purchasers of products from industries that pollute by lowering the cost of those products, or by subsidizing in any form the cost of controlling pollution. We probably do our best job by making the product, and the users of the products of those facilities, bear that cost.

Now, in the retrofit period, I think a stronger argument could be made as a transitional rule that here both State and local as well as Federal Government restrictions came in, that you ought to give some relief. Even then, economics probably weren't sound but the equities probably were. But now we are in a period, for the most part, when we are talking about new facilities; pollution control is clearly a desirable objective.

There are a number of ways to obtain it by design of plant and other ways. I think we are simply misleading ourselves if we continue to talk in terms of somehow subsidizing a portion of a plant which is for pollution control, a portion of the plant which is productive capacity.

Mr. CONTE. Well, you must have been with big business before you came to Government. I don't think you understand the small business problem. He doesn't have that liquidity then, and he just can't afford to put in that piece of equipment.

When he puts in that piece of equipment for pollution control, it's the public that benefits from it. They get cleaner air, a cleaner environment as a result of it; so they're going to benefit from it. But are you sitting there telling me that you're ready to see a lot of small businesses go under?

Mr. CHAPOTON. Oh, absolutely not.

Mr. CONTE. That's what is going to happen. You know it, and I know it.

Mr. CHAPOTON. There would still, even with the OMB–SBA program, be some definite benefit for financing of pollution control

facilities. Indeed, outside of the SBA guarantee program, there will still be the ability to use tax-exempt financing for pollution control facilities under our proposal, if Congress adopts them. That will still be possible. There will be new restrictions on it, but for small business, there will be precious few restrictions.

So what I'm saying is that economically, the desirable result is to have the cost of the product bear the cost of controlling pollution. For the individual small businessman, I concede that's a weak answer because it tells him, "Well, you've got to spend money that's nonproductive and just raise the cost of your product."

And he says, "Well, I don't have the money. So telling me to raise the cost of the product is no answer." And in the short term, I understand those problems. But long term, when we are establishing national policy, I think it is not wise to try to sweep those costs under the rug.

Mr. BEDELL. Will the gentleman yield on that? Mr. Chapoton, I don't think you understand the situation. The situation as I understand it, is that big businesses can sell pollution control bonds, tax-exempt pollution control bonds at this time. By your ruling, you're saying that small businesses can't do it. Do you understand that?

Mr. CHAPOTON. Well, you mean because they need the Federal guarantee?

Mr. BEDELL. No, no, your ruling discriminates against small business in that big business can still sell pollution control bonds which are exempt from taxation. Small business under your ruling simply can't do it. Now, if we bought your argument that we shouldn't interfere, and the users have to pay, and so on, and taxpayers shouldn't, that's fine. But what many of us are very disturbed about is the way you're going after small business as compared to big business. Do you understand that's what is happening?

Mr. CHAPOTON. Mr. Chairman, I don't understand. You mean that Revenue Ruling 81-216 would prevent the small businesses from selling pollution control bonds?

Mr. BEDELL. That's right.

Mr. CHAPOTON. Well, a great majority of the small issue bonds, bonds of that nature, are just direct bank loans which are issued under the guise of a tax-exempt obligation.

Mr. BEDELL. You don't mean that.

Mr. CHAPOTON. Yes, sir.

Mr. BEDELL. Does your Department think that the tax-exempt small business pollution control bond issues are simply loans from the bank? Is that what the Treasury Department thinks?

Mr. CHAPOTON. At the current time, yes. Most tax-exempt business obligations, that is true.

Mr. BEDELL. Because those lenders buy the bonds, is that what you're saying?

Mr. CHAPOTON. No; it is even part of the loan department of the bank as opposed to the bond purchasing department of the bank. Most of them are bank-loan type transactions now.

Mr. BEDELL. On industrial revenue bonds?

Mr. CHAPOTON. On industrial revenue bonds, yes, sir. I say most of them. That's a little generalized statement, but that's it by and large.

Mr. BEDELL. So you believe that big business should be able to get the tax-exempt status, but small business should not be able to get the tax-exempt status?

Mr. CHAPOTON. No, on the contrary, they are equally available to both classes of business.

Mr. BEDELL. No, they're not, because without the loan guarantee, there is no way in the world that small business is going to get them. As I understand it, there are normally packaged revenue bond issues. Is that correct?

Mr. CHAPOTON. Yes, sir.

Mr. BEDELL. See? Without the loan guarantee, the banks are not going to loan on a 20-year period to the small businesses, I don't think, are they? Do you think they are?

Mr. CHAPOTON. No; I do not think that banks are going make a to loan of $20 million for a 20-year period.

Mr. BEDELL. You just said the banks are making the loans.

Mr. CHAPOTON. Well, I'm sorry, we are getting confused. I thought you were talking about Revenue Ruling 81-216. You're referring to the SBA program.

Mr. BEDELL. Sure. I'm talking about the fact that your ruling has made it impossible, in effect, for small business to get tax-exempt financing for pollution control equipment whereas big business can still continue to get it.

If I'm wrong on that, then you better set me straight. If I'm right, you sure as heck better know it because at least some members of this committee think that what you're doing is singling out small business and saying, "We care about big business, but we don't give a darn about small business. We're going to cut it off for those," and at least many of us think they need it worse than big business does.

I yield back. Thank you, Mr. Conte.

Mr. CONTE. You're right on target. I had that same question. Isn't there also a bias in your policy? Can't big business go get tax-exempt financing for pollution control through the "Exempt Facility" exemption? And now as a result of OMB's order, and the Revenue Ruling 81-216, small business cannot but big business can.

Mr. CHAPOTON. For my clarity as well as for our discussion, I would like to distinguish between the SBA program. I see your premise is that without the SBA program, small business simply will not be able to issue tax-exempt bonds because they need the guarantee. Indeed, big business can because it doesn't need the guarantee.

Well, now, I would not argue with the result if your premise is correct that small business simply cannot sell bonds. It cannot sell obligations without a Federal guarantee. To the extent that that's true, and you do away with the Federal guarantee, your premise is correct; I concede.

Mr. BEDELL. Does the Treasury Department think that small business can, in practicality, issue tax-exempt revenue pollution control bonds in these small amounts? If you believe that, then we need to know that that's the basis of your decision.

Mr. CHAPOTON. Well, Mr. Chairman, I don't want to confuse it with the basis of our decision. Let me first state that, indeed, small

businesses do issue obligations all the time. Some small businesses are going to need guaranteed issue bonds; some are not.

Mr. BEDELL. So that the Treasury Department believes from a practical standpoint, small businesses can issue pollution control tax-exempt bonds?

Mr. CHAPOTON. Taxable—yes.

Mr. BEDELL. Thank you very much.

Mr. CONTE. That was the reason we set up the program because small business couldn't do it.

Mr. Secretary, one of the reasons I say that these IRB's are of significant importance to small business is because of the way the program is operated in the State of Massachusetts. A recent study by the Massachusetts Industrial Finance Agency gives a great deal of credence to that.

The agency surveyed more than 800 Massachusetts firms which have issued more than $1 billion of tax-exempt bonds from MIFA since it was established in 1978. It found that the IRB's had contributed greatly to the ability of small companies in the State to expand. More than three-quarters of the firms assisted by MIFA had sales of less than $20 million, while almost half were under $5 million. Of the one-third of the companies responding to MIFA's survey, 93 percent said they would have been forced to alter their investment plans if the IRB's weren't available.

One-third claimed they would have canceled their expansion plans. Nearly another third said that expansion would have been delayed. One-fifth said their projects would have been slashed, and about 5 percent said they would have sought to expand in another State.

In 3 years, MIFA has added 47,000 new permanent jobs and 18,000 man-years of construction work. Mr. Chairman, I would like to enter into the record MIFA's 1981 annual report. What do you think of those statistics?

Mr. BEDELL. That report will be entered in the record, Mr. Conte.

[The MIFA report has been retained in the committee's files.]

Mr. CONTE. Thank you. Very impressive, aren't they?

Mr. CHAPOTON. Well, I agree they are. I think we always have to look at—I don't want to duck the question—but at a broader view of the financing done in this sector. What is it doing to other sectors? I concede that lowering the interest cost through tax-exempt obligations makes it possible for some small businesses to make investments and certainly makes it easier for some small businesses to make investments they would not otherwise make.

Whether that investment is for pollution control or for other purposes—quite apart from the SBA program—we have examined in depth the use and in some cases, I think we would all agree, the abuse of tax-exempt financing.

We have a proposal that we have presented to the Congress that would restrict it, but it would not deny it to small business. Indeed, it would make it clear that the composite issue is available, provided though, that it is limited to the small user which certainly was not the case under prior law. That is our proposal.

Now, the small user would be subject to the general restriction that he could not also take accelerated cost recovery deductions but a small user, and that would be one who is defined as not making

more than $20 million of capital investment over the 6-year period, 3 years before and 3 years after the bond issue, would, indeed, be entitled to use tax-exempt financing for pollution control or small issues for any facility and could issue those bonds in a composite manner.

Mr. CONTE. I'm really worried because unemployment is on the increase. You agree on that.

Mr. CHAPOTON. Yes, well, it's up yesterday.

Mr. CONTE. Sure, it's on the increase. And the administration is cutting out every single program which would put people back to work: the Job Corps, manpower retaining program, cutting the Export-Import Bank which provides hundreds of thousands of jobs in this country, and exports. There is another program that's proven successful. Sure, it's going to cost a little money. No doubt about it, but it puts people to work. How can you cut all these programs that put people to work? I can see where you are going to have to cut a lot of programs. Why cut the meat and potato programs?

Mr. CHAPOTON. Well, Mr. Conte, you are getting a little beyond my area. When the budget cuts are made, they are painful across the board. I know you've heard and we have all heard the programs that are being cut are debated back and forth. The cuts need to be made in some areas, and they're going to be painful wherever they are. Certainly, all of our approaches in this area, particularly are going more to the free economic marketplace, and that is the overall policy. There are going to be hardships in particular areas. I cannot answer your question very specifically.

Mr. CONTE. I, again, have reiterated I feel that cuts have to be made. But I think the architects of these cuts aren't very practical people; they've got blinders on. They are not seeing what these programs do, how good they are. I agree with you. We ought to go back to free enterprise system. But when you're in trouble like we are and the wheels are coming off and every day gets worse and worse, and everybody has got the same blinders on. Everybody's got the same answer; somebody has got to start doing something.

Thank you, Mr. Chairman.

Mr. BEDELL. Mr. Molinari.

Mr. MOLINARI. I have no questions.

Mr. BEDELL. Mr. Chapoton, some of us in the Congress have felt that the administration is intentionally discriminating against small business as compared to big business. Do you see the administration as doing so?

Mr. CHAPOTON. No, Mr. Chairman, but I am very sensitive to that charge in the tax area. That charge has been made repeatedly. I deal constantly with small business groups. I've told them that we are concerned about that perception. We don't think it's true, but we are very concerned about that perception and we want to correct it. Indeed, I have met with the small business groups—particularly, the NFIB and the other small business groups—at some length to see what their concerns in the tax area are that we could alleviate. I think we have been of some help in that area, but I recognize the charge is constantly made.

Mr. BEDELL. If it could be shown to you that certain policies were discriminatory against small business as compared to big business,

would you and would the administration be receptive to possible change in those policies so they were not discriminatory?

Mr. CHAPOTON. We certainly would not like to be discriminatory, so the answer would have to be yes.

Mr. BEDELL. So you would?

Mr. CHAPOTON. Yes, sir.

Mr. BEDELL. You testified, indeed, these bonds were available to small business just as they were available to big business.

Mr. CHAPOTON. Yes.

Mr. BEDELL. Do you know how many tax-exempt small business pollution control bonds have been issued since your ruling?

Mr. CHAPOTON. No; I do not. We could attempt to—excuse me—you're talking about the SBA ruling?

Mr. BEDELL. Yes.

Mr. CHAPOTON. There is some concern about that——

Mr. BEDELL. Our understanding is that that was mandated to the SBA. Did we misunderstand things?

Mr. CHAPOTON. Well, it is my understanding that the OMB, in conjunction with the Federal credit policy that is certainly supported by the Treasury Department, and supported by my office, as well, did say that we should not have both tax-exempt financing and a Federal guarantee. So in that sense it was mandated; yes, sir.

Mr. BEDELL. By the administration. If I understood your testimony correctly, you said that these tax-exempt pollution control bonds are available to small business the same as big business so it is not discriminating.

Mr. CHAPOTON. That's correct. I mean, in some cases small businesses are going to be helped, and in some cases, maybe, it would be essential if they have a Federal guarantee. But certainly, small business does finance the new facilities constantly.

Mr. BEDELL. Let me read to you from a letter we have from Kutak, Rock & Huie, which I would suggest we enter in the record. Without objection, it will be so. [See app. D.]

They are counselors who help with the issuance of such bonds. I won't read the whole thing but I would like to read this one paragraph to you:

> For the sake of comparison, we outline the cost of issuance of a $10 million industrial development revenue bond and a $10 million registered corporate debt offering to the public. While $10 million may appear to be a high figure to select for an initial public offering by a small company, it is economically unfeasible to publicly offer a smaller amount of taxable debt because the issuance costs, other than the underwriter's discount, are largely fixed and constitute too great a percentage of the borrowing.

Would you say that limiting it only to people who were going to use $10 million for their pollution control would not be discriminatory against small business?

Mr. CHAPOTON. Mr. Chairman, I would not agree with the premise on which that letter proceeds. The cost of a smaller issue per dollar of bond is going to be higher, but pollution control financing is done by a small business every day.

Now, if you're talking about issuing long-term bonds in the pollution control market as well as in every other facility being financed, big business can issue long-term bonds because of their

wherewithal and because of their place or their position in the debt market, and small business cannot.

Now, that is not a discriminatory policy in the administration. That is the economic system working.

Mr. BEDELL. So it's the belief of the Treasury Department that if I were a small business and needed $50,000 for pollution control equipment to meet the rulings that were made by the Federal Government under EPA, that it would be possible for that small business to successfully get somebody to offer and to be able to sell tax-exempt pollution control bonds to cover that $50,000 over a long period of time, 20-year bonds, to cover that $50,000 of equipment?

Mr. CHAPOTON. No, my point is the small businesses problems of availability of debt capital would be the same for that investment as it would be for any other investment made by that small business.

Mr. BEDELL. You're not answering my question. You're heading me off in the other direction. We are talking about financing for pollution control equipment which the Government has mandated has to be done. You agree with that?

Mr. CHAPOTON. That's a correct statement.

Mr. BEDELL. Some small businesses need to invest $50,000 which, for them, is a large amount of money, in order to get such equipment. Are you telling me that the Treasury Department believes that that small business can issue a pollution control tax exempt bond for $50,000 and get lawyers to handle it and get it sold?

Mr. CHAPOTON. It's hard to answer that in the abstract.

Mr. BEDELL. Just answer it. Do you think they can or do you think they can't?

Mr. CHAPOTON. Well, in some instances, they can but they could not as cheaply as a big business.

Mr. BEDELL. But you think they can do it?

Mr. CHAPOTON. In some instances. I cannot say. In some instances, they can and do issue long-term debt.

Mr. BEDELL. Mr. Chapoton, it's very clear. Either we are discriminating against small business or we're not. Just let me finish, if I may. Either we are discriminating against small business or we're not discriminating against small business.

If we have rulings which say a big business which needs $10 million worth of pollution control bonds, can sell those bonds—tax exempt bonds—but small businesses which need $50,000 worth of pollution control equipment, which is a bigger investment compared to their net worth than the $10 million to the big corporation, cannot get such financing, then, at least, I think almost everybody would say that if that's because of Government rules and regulation, the Government is discriminating against small business.

Now, the question is what the people who are making these rules believe. I guess the first question is, do the people that are making these rules believe that it is not discriminating against small business for this tax exempt financing in practical use to be unavailable to small business where it is available to big business because of the rulings of those people in Treasury and in policies of the Treasury and OMB? It's very clear. Either it's available to both or it's not available to one.

If it is not available to one, why is it not available to that one? At least some of us think it's because of your rulings and if that is the case, then the question is, is your ruling because you don't understand that small business cannot sell, for practical purposes, a $50,000 20-year pollution control bond?

If you think they can, then we need to get your thinking straight, because you've testified that you don't want to discriminate.

Mr. CHAPOTON. If discrimination exists, it is not because of Treasury or OMB rulings. There are problems for small business that don't exist for large business.

Mr. BEDELL. Just a minute. I have to interrupt.

Mr. CHAPOTON. OK.

Mr. BEDELL. Did your ruling or did your ruling not, in practicality, make it impossible for that company that needs $50,000 worth of pollution control equipment to get tax-exempt financing for that equipment?

Mr. CHAPOTON. It did not.

Mr. BEDELL. Well, if it did, would you then consider changing the ruling?

Mr. CHAPOTON. No, I think the——

Mr. BEDELL. You wouldn't change it even if it did?

Mr. CHAPOTON. If it denies it, it's not because the ruling denied it. It's because the small business has a different problem.

Mr. BEDELL. No, Mr. Chapoton, they could get it before. Before your ruling, they could get it. After your ruling, they cannot get it. Now, tell me, if that's the case, how your ruling had nothing to do with them not being able to get it?

Mr. CHAPOTON. OK, if you proceed on that premise, the ruling——

Mr. BEDELL. Is that premise wrong?

Mr. CHAPOTON. We would say the policy was wrong.

Mr. BEDELL. No. Some of us believe that prior to your ruling, that small businesses could get tax exempt financing for pollution control equipment.

Mr. CHAPOTON. Absolutely.

Mr. BEDELL. But since that time, we think that, in effect, they cannot. Now, is that premise incorrect?

Mr. CHAPOTON. I think that premise is incorrect.

Mr. BEDELL. So Treasury thinks that premise is incorrect?

Mr. CHAPOTON. Yes.

Mr. BEDELL. If that premise is correct, then would you consider changing the ruling?

Mr. CHAPOTON. Well, if you considered changing the ruling—I'll give you a straight answer. But if you consider changing the ruling, what you would have to say is that our policy on the dual benefit of tax exempt and Federal guarantee is wrong. At least it should not be applied in the small business area involving pollution control. I understand that probably is this subcommittee's feeling. Now, you would say that policy acts to discriminate against small business, I take it?

Mr. BEDELL. That's not our feeling at all. It's not this gentleman's feeling. This gentleman's feeling is that you had put in a policy which you thought was good as an overall policy.

Mr. CHAPOTON. Yes, sir.

Mr. BEDELL. That you didn't realize what you were doing in that what you were doing was putting in a policy that completely discriminated against small business as compared to big business. I'm not saying that you were intentionally doing something. I'm saying that was the result and we have you here to let you know that that's the result. I had hoped that the administration would feel that if that is the result, it isn't what we want to do.

But I get the impression from talking to you that whether that is the result or not, you have no intention of changing your policy. Apparently it takes politics to change your policy. Apparently you've changed it for homeowners; I understand you're recommending tax-exempt bonds for building housing which you have your choice of whether you want to build a house or not. But the Government tells the small business that they have to put in pollution control equipment, and apparently, you want to change your policy to make it, in fact, impractical to do that at least under the same terms as big business can. That's our concern, Mr. Chapoton, and I've taken too much time.

Do you have anything more, Mr. Conte?

Mr. CONTE. Yes, sir, if I may. Mr. Chapoton, you're familiar, I'm sure, with the language of Public Law 97-92, the third continuing resolution section 112, are you not?

Mr. CHAPOTON. Yes, sir.

Mr. CONTE. I know you're not crazy about that. To tell you the truth, that's not the language that I drafted either, so we both can be honest about this language that we have to deal with.

Now, it seems to me that the key language is between paragraphs 2 and 3 under (a)—"in connection with the qualified issue." If I read that right, paragraphs 1 and 2 only apply with regards to a qualified issue. Is that correct?

Mr. CHAPOTON. Mr. Conte, I think that's correct. I must say that I agree with you, that the language is inartfully drafted and I have to go back through that each time. But, yes, I believe that is correct.

Mr. CONTE. A qualified issue is very limited to bonds guaranteed by a State or to agricultural bonds; is that correct?

Mr. CHAPOTON. Yes, sir.

Mr. CONTE. Except for the paragraph on disqualified facilities, would it be correct to say that this section does not deal with the effects of 81-216 on unqualified issues?

Mr. CHAPOTON. I think that's correct, Mr. Conte. I believe that's where I've analyzed this before but I have to go back through it. I would like not to be held to that until I have a chance to do so.

Mr. CONTE. Does that mean that 81-216 and the proposed regulations are still operative with regards to unqualified issues?

Mr. CHAPOTON. Mr. Conte, I understand the purpose of your argument. I'm reluctant to walk down the legal interpretation point without frankly having the opportunity to familiarize myself with it. Let me summarize by saying that I think a sound legal argument can be made that the grandfather rulings could go forward. A sound legal argument can be made to the contrary and you, I think, appreciate fully the dilemma that we're faced with. The chairman of the Ways and Means Committee certainly interprets it

that grandfather rulings cannot go forward, and has made that clear both in the congressional debate and to us.

Mr. CONTE. He was not the sponsor of the amendment, and I think we are going to have to go by congressional intent. You have to go to the sponsor of the amendment, and I was the sponsor of the amendment. This was the intent. The majority of the Congress passed it.

I just want to make it clear for the record, the kind of bond that is being stopped because of Treasury's interpretation and because of Revenue Ruling 81-216. During 1981, Massachusetts Industrial Financing put together a pilot program to raise $25 million for small unrated firms in the national credit market. Using letters of credit and guarantees from local and national institutions, unrated firms would achieve an AAA credit rating. Interest in this novel program was strong. It would have been the very first in the United States. It would have gone a long, long way toward meeting the credit needs of small unrated firms.

That program was within days of being announced when Revenue Ruling 81-216 came down. I hope you can understand why I, as a Representative of Massachusetts and a member of the Small Business Committee for over 18 years, am so upset with 81-216.

Mr. CHAPOTON. I can understand it fully, yes, sir.

Mr. CONTE. Thank you, Mr. Chairman.

Mr. BEDELL. Mr. Hiler, did you have any questions?

Mr. HILER. No.

Mr. BEDELL. Mr. Molinari?

Mr. MOLINARI. No.

Mr. BEDELL. The Small Business Committee, Mr. Chapoton, and certainly this chairman are not here simply to scream at you. I would hope we are here to try to see that we have policies which are fair and proper in our society.

I'm a Democrat; the rest of the members here are Republicans.

I could go with great joy at your statements here because I can go out and make all sorts of political speeches telling what you've said here and this sort of thing, and I think I could clearly show the audiences to whom I speak that your department and the administration simply don't care about small business and that you are perfectly willing to let benefits which accrue to big business go on while you cut them out for small business. That's really not my desire, though, Mr. Chapoton.

What would you do about this if you were me, other than to just make political hay out of it?

What would you do if you were sitting where I am, and you had somebody come before you and indicate that even if it was shown that their policies were discriminating against small business compared to big business, that they were not willing to change those policies?

What would you do in order to try to get that changed, if you were me?

Mr. CHAPOTON. Well, as I said earlier, Mr. Chairman, I recognize very clearly your concern. Let me correct my remarks. When you state the premise that the policies can be shown as discriminatory, I guess the starting point is that if there is no policy in effect, if

there is no assistance to small business or large business, in either case, there is, in the marketplace, a discrimination.

Mr. BEDELL. No, that's not my point. My point is that you do have a policy which lets big business sell tax exempt pollution control bonds and the practicality is that small business cannot do that because the costs of selling the bonds are so great they cannot afford to do it.

We had testimony recently that said that it would cost a minimum of $50,000 in legal fees for a small business to simply issue bonds. So if you are going to rule that they can't package them, and if you are going to rule that the Small Business Administration cannot guarantee them, the fact is that nobody can spend $50,000 to try to get a $50,000 bond issued. Surely, you don't have to be a brilliant person to understand that.

Mr. CHAPOTON. No.

Mr. BEDELL. Previously that was available because of the guarantee and the packaging. Your policies have wiped that out while still leaving in the tax-exempt bonds for big business.

You know, to me, this is so clear and I don't want to yell and scream at you but some of us cannot understand why, if that is the case, and I don't see how anybody could possibly disagree with that, if that is the case, why it is that you would not consider changing your policies so that those were available, particularly in view of the fact that they have to do it because of a Government ruling, a Federal Government ruling by the EPA? That's what we can't understand. At least the chairman can't understand it.

Mr. CHAPOTON. I think the practical result is, that small business, if they cannot issue long-term bonds, which is your premise, without a Federal guarantee, that they will have to do it through private placement tax-exempt financing which is what they do on other facilities.

Now, it's true that they would then not have the same benefit as large business does for any type of financing when large business can issue 20- to 25-year bonds or used to be able to. They cannot do it currently because of market conditions, but can issue long-term bonds for financing any type of facility. Small businesses have traditionally been able to finance new construction. They will have to through private placement, but tax exemption will still be available.

Mr. BEDELL. That's really not the issue, Mr. Chapoton. The issue is, you have instituted rulings which have completely changed the policy from one in which small business could do it in competition with big business to one in which your new policies make it impossible for them to do it in competition with big business. That's the issue, Mr. Chapoton. That's the issue that Democrats are going to be talking about and it is unfortunate because we would a heck of a lot rather see you change your policy so you're fair to small business. That's the whole issue, Mr. Chapoton. We're here, the chairman is here, as a friend of yours saying, for God's sake, we are only talking about a small amount here in terms of pollution control bond financing. It's not a big thing. You know, this isn't something that's going to ruin our economic or financial markets or anything.

But sure as heck, you're painting a picture which, at least I think any Democrat can talk to any audience—Republican and

Democrat—and I can talk to all my people and tell them exactly the facts and be exactly honest in what I'm telling them, and clearly, I think, they are going to agree that you have taken action which is exactly discriminatory against small business, and I can't understand why you would want to do that under the circumstances.

Mr. CHAPOTON. I think I would describe our action as eliminating the rule which eliminates what you would refer to as the discrimination that exists in the marketplace. The rule that eliminated that discrimination was allowed in a Federal guarantee and tax exemption, but it conflicts with the Federal credit policy. It does not deny funds to small business. Let me concede, Mr. Chairman, it does deny the small business the ability to issue long-term debt for this type of facility in the same way that they denied long-term debt for other types of facilities.

Mr. BEDELL. All I've got to do is repeat that exact statement to my audiences if I want to just absolutely prove my point, Mr. Chapoton.

Well, all the chairman knows at this time is to plead with you to realize what is happening. I think the other thing that disturbed me somewhat is that you testified that allowing SBA guarantees for tax-exempt pollution control obligations is directly contrary to the policies expressed by Congress in those enactments. You're talking about a 1941 law—and in 1976, Congress passed legislation that clearly stated otherwise. Are you aware of that?

Mr. CHAPOTON. Yes, I'm aware of that. There have been a number of acts, I think.

Mr. BEDELL. If you're aware of that, why would you put in testimony only about the 1941 law and not put in what is the most recent legislation which clearly indicates that Congress does want this the other way? Why would you do that?

Mr. CHAPOTON. I think the 1941 law was the starting point of a long standing Federal credit policy, and that policy has been reflected in numerous pieces of legislation since then, and I understand the argument that it conflicts with the SBA program that was adopted in the midseventies.

Mr. BEDELL. Which would you think we should go by? The last law passed or the first law passed?

Mr. CHAPOTON. From our policy standpoint, we start cutting back in these areas of Federal credit guarantees. We certainly would look to, and OMB did look to, a long standing administration and, indeed, Government policy on Federal guarantee of tax exempts. Now, that obviously is in conflict now, but that is the policy that we followed and it is consistent with the policy that we followed all along.

Mr. BEDELL. The other question the chairman would have is that you say, "Current law, however, does not require the showing of any genuine public purpose for the project to be financed with a tax-exempt obligation."

Mr. CHAPOTON. That is correct.

Mr. BEDELL. So you don't think that financing for pollution control equipment in and of itself shows public purpose?

Mr. CHAPOTON. In many instances, when you look at the actual facts, it is very difficult to define public purpose.

Mr. BEDELL. For the project to be financed?

Mr. CHAPOTON. That's correct.

Mr. BEDELL. You don't think they need to put in their pollution control——

Mr. CHAPOTON. Oh, sure they need to put in pollution control to startup the plant.

Mr. BEDELL. "Current law, however, does not require the showing of any genuine public purpose for the project to be financed with tax-exempt obligations." These projects are pollution control projects. You do not think that pollution control projects necessarily serve a public purpose?

Mr. CHAPOTON. As I stated earlier, indeed, financing at cheaper rates or subsidy is probably not a good public policy.

Mr. BEDELL. No, but that's not what you said. "Current law, however, does not require the showing of any genuine public purpose for the project to be financed with tax-exempt obligations." I took it you meant, public purpose for the project, or didn't you mean to say that?

Mr. CHAPOTON. No; I meant to say that. There is no showing at a local level of a public purpose. The only showing is that for tax-exempt financing to exist, that it be a nonproductive pollution control facility.

Mr. BEDELL. Well, I hope that the record will clearly show that the Treasury Department thinks that there is not necessarily a public purpose for a project for pollution control equipment. I hope that this will clearly show that that's your testimony, because I'm pretty sure that they would want to know in some of the other committees of the Congress, that you see no public purpose for projects to control pollution control.

Mr. CHAPOTON. Well, Mr. Chairman, I accept your point. Our concern throughout tax-exempt financing has been, and I think that probably would be a better statement, if it said there is no showing of a local public purpose. That is because the local government does not pass upon the desirability of the tax-exempt financing for the project.

Indeed, the only tax-exempt financing that is available is to a local government, not to a private business.

Mr. BEDELL. Further in your statement, you say, "Thus, the allocation of capital investments is based upon Government decision rather than the relative economic productivity." That's your argument as to why we should not involve ourselves in this. Surely, you would agree that pollution control equipment is there because of Government decisions rather than its relative economic productivity, would you not?

Mr. CHAPOTON. That's correct. But that doesn't change the fact that we've decided that businesses—users of businesses should—users of products which pollute in their manufacturing, when they are manufactured, should pay the cost of manufacturing that facility.

Mr. BEDELL. This is a different issue. But you understand what you're saying? You're saying that capital should be allocated completely according to the free market without Government interference. But then the Government, rightly or wrongly, is saying, "Yes,

but we are going to tell you that you've got to spend your money in this area." Do you understand?

Mr. CHAPOTON. Yes; I understand your point.

Mr. BEDELL. I think that many small businesses will say, "Well, gosh, this is a free market, but they're telling us that we've got to do this and we've got to do that, and then they're cutting off the financing for doing it." I've monopolized the time.

Mr. Hiler, do you have anything?

Mr. HILER. No; Mr. Chairman.

Mr. BEDELL. Mr. Eckart.

Mr. ECKART. It's not the first time I've been confused this morning.

I have perused your remarks—yes?

Mr. BEDELL. Mr. Eckart, would you take the chair? The chairman is supposed to introduce somebody at another hearing.

Mr. ECKART. Go right ahead. I'll be happy to. Hopefully, I'll then have greater incentive to keep my questions limited so we can adjourn the meeting.

Mr. BEDELL. Thank you for coming, Mr. Chapoton. The chairman hopes that you will reevaluate your situation.

Mr. CHAPOTON. Thank you, Mr. Chairman.

Mr. ECKART. Let me just simply say that one of the serious problems raised in the last session's testimony where representatives from my home city came in and testified that the public taxable bond market is not amenable to smaller issues, and that once they drop below the $8 to $10 million range, people who market these issues really say there is not much of a market for them.

The average size of the loan guarantees under the SBA program has has been in the $2 to $3 million range.

What I am afraid that we are going to ultimately see is that nobody will want to sell what is out there, if, in fact, anything is out there, because it is too small. But the small businessperson is going to have the EPA on one side of them, lack of financing capability on the other side of them, and they are going to opt to close their door. Closing their door as a direct result of two conflicting Government activities: One which tells them to do something and one which takes away from them their way of doing what they are told to do.

That is simply the only conclusion that I can draw from your testimony today, and the testimony that preceded you from small businesspeople from all around the United States. They want to comply with the law. They want to meet what I believe to be a valid public purpose stated in the law, that of controlling certain environmental emissions. The only way out, because of their size and because of the cost and the complexity of installing the required equipment to meet the Government needs, is being taken away from them.

So, therefore, this administration is holding their feet to the fire by its policies and pouring gasoline on the fire at the same time. I don't know where the small businessperson goes under those circumstances.

Mr. CHAPOTON. Mr. Eckart, what you're assuming is once the EPA requirement is imposed upon the business, small or large, but in this case small business, that there should be a Federal benefit,

Federal subsidy to help them meet that obligation. We make two points. One is that if you are going to do it, that tax-exempt financing is a very inefficient way to do it, and perhaps I should emphasize that a lot more.

It is clearly an inefficient way to do it, and that a lot of the benefit goes to persons other than the user, that is, it goes to the tax-exempt bondholder. In addition the problem that is before the subcommittee today more than the inefficiency of tax-exempt financing, is the combined benefit of tax-exempt financing and Federal guarantee is a dual benefit and is inconsistent with a long standing Federal credit policy of the Government, not just this administration, but of the Government for a number of years.

I understand the chairman's point that it denies access of small business to the long-term market, but I submit that is the marketplace that denies that, not any policy.

Indeed, if we are going to eradicate that discriminate, that is, small business has less access to capital markets than big business, then we have to put a bias to small business, and that is what the SBA program does. In doing so, we conclude that it is inconsistent and undesirable and inefficient Federal credit policy, and therefore, we do not want to continue it.

Mr. ECKART. Well, if I make two assumptions: No. 1, that it is, in fact, inefficient, which is true, and second, that you really don't think there is, in fact, not a valid public purpose to controlling these pollution emissions, then what would be an efficient way of helping a small businessperson meeting——

Mr. CHAPOTON. A much more efficient way would be a direct subsidy to small business to reduce their costs. Certainly all the benefit would then go to the small business, and it would be an on-budget type item.

Mr. ECKART. Are you testifying in support of us increasing or making a direct appropriation in that regard?

Mr. CHAPOTON. No; I'm not doing that but I am saying that if this money is to be spent that is now being spent through tax-exempt financi[illegible] for all pollution control, if it were done through a direct subsidy, it would be more efficient to the users.

Mr. ECKART. But you're not supporting that?

Mr. CHAPOTON. No, I'm not supporting that. That would take up—indeed, as I made it a point in my statement, it is probably from a broader economic policy standpoint, undesirable to subsidize pollution control or polluting manufacturing facilities or polluting facilities because then the users of products of those facilities indeed are not paying the full cost of producing that product. That's from a broader standpoint. That is an undesirable policy although I think that is a very unsatisfying answer to the small businessman who is just worried about financing the facility, in general.

He now has available tax-exempt financing, as I understand the point of the subcommittee, as a result of the SBA withdrawing its guarantee that he does not have the same market as to big businesses. He still has tax exempt financing, indeed, through private placement Tax-exempt financing for pollution control for small business is done and done all the time.

Mr. ECKART. What do you support then?

Mr. CHAPOTON. Well, we support the change in the SBA policy. We also support changes in the tax-exempt financing rules for private purpose tax-exempt bonds as outlined in the statement attached. In the technical explanations attached to my statement, which would restrict the use of tax-exempt financing significantly, would allow those small businesses to continue to use small issue tax-exempt bonds, and would allow them to be issued in composite issues so that the efficiency lowering cost per dollar issue would be available.

Mr. ECKART. My colleague from Indiana, Mr. Hiler?

Mr. HILER. I just have one question. If there were no tax-exempt capabilities in the marketplace, and there were no loan guarantees at all in the marketplace, what effect do you think that would have on the interest rate structure that we see today?

Mr. CHAPOTON. That's a very difficult question. I think the loan guarantee, certainly, the credit people in the administration—Treasury and OMB—point out again and again that the Federal guarantees have the affect of preempting the private market because the lender looks upon that as a Federal obligation, and it stands ahead of all private obligations.

So I assume if there were not Federal guarantees, it would be of significant assistance to the private capital markets. The tax-exempt market operates in a different arena and if you had no tax-exempt financing for private users, you would certainly lower dramatically the cost of capital to cities, States, and localities because as I stated earlier, private purpose tax-exempt bonds will now consume this year 55 percent of the entire tax-exempt market. So that means cities and localities are out there competing with big and small business for tax-exempt bonds.

Mr. HILER. I mean tax exemptions for anybody, including cities and municipalities and school boards and the whole ball of wax.

Mr. CHAPOTON. That proposal would require a lot of study.

Mr. HILER. But in theory, though, what would happen? In theory, the interest rates should come down, shouldn't they?

Mr. CHAPOTON. Yes, the interest rates should come down.

Mr. HILER. Probably rather dramatically.

Mr. CHAPOTON. That is possible. All money that now goes into the tax-exempt market would come into the taxable market, obviously, and you probably would have a lot more efficient market.

Mr. HILER. Thank you.

Mr. ECKART. The last thing I would like to do is to say thank you for finally coming here to talk with us. I know that that issue has been raised before. We have had—it is important for you to understand how this committee has been deluged from the small business people, financing individuals and other governmental officials including—Governor Millikin of Michigan, and Governor Rhodes of Ohio, two States hard hit by the serious economic circumstances that our country finds itself in today. [See apps. E and F.]

Governor Rhodes points out that this particular form of pollution control financing affects almost 6,000 jobs in Ohio, the State that is experiencing well over 10 percent unemployment; 46 million dollars' worth of projects. He says in a letter that, without objection, I'd like to insert into the record, that "Ohio will find itself in the unpalatable position of having to enforce Federal pollution laws

against Ohio businesses that may be violating those laws because of a Federal policy change which then destroys their ability to comply. That is bad government." [See app. F.]

That's our Governor's assessment. I don't know how we come to square with that and the desired changes suggested by OMB, but I want to thank you for being here. There being no further business to come before the subcommittee, we stand adjourned.

[Whereupon, at 10:32 a.m., the subcommittee was adjourned, to reconvene subject to call of the Chair.]

APPENDICES

APPENDIX A.—DOCUMENTS SUBMITTED FOR THE RECORD BY HON. SILVIO O. CONTE

BERKLEY BEDELL, IOWA
CHAIRMAN

NICHOLAS MAVROULES, MASS.
CHARLES HATCHER, GA.
DENNIS E. ECKART, OHIO

SILVIO O. CONTE, MASS.
JOHN HILER, IND.
GUY V. MOLINARI, N.Y.

MARC N. FRUMKIN
SUBCOMMITTEE STAFF DIRECTOR
202-225-3941

JAMES M. KILDUFFEY
MINORITY SUBCOMMITTEE COUNSEL
202-225-4241

United States House of Representatives
Committee on Small Business
Subcommittee on Energy, Environment, and
Safety Issues Affecting Small Business
B-363 Rayburn House Office Building
Washington, D.C. 20515

March 11, 1982

Honorable Berkley Bedell, Chairman
Subcommittee on Energy, Environment, and
Safety Issues Affecting Small Business
B-363 Rayburn House Office Building
Washington, D.C. 20515

Dear Berkley:

Enclosed with this letter are a number of documents which were mentioned at the hearing yesterday. Their inclusion into the record, I believe, would help clarify a number of points that were raised. I ask that they be included in the hearing record.

Thank you for your consideration.

With best wishes, I am,

Cordially yours,

Silvio O. Conte
Member of Congress

SOC/jmk

EXHIBIT 1.—LETTERS TO JOHN CHAPOTON, ASSISTANT SECRETARY OF THE TREASURY

RANKING MINORITY MEMBER
SUBCOMMITTEES:
TRANSPORTATION
LABOR-HEW
LEGISLATIVE
EX OFFICIO MEMBER
OF ALL SUBCOMMITTEES

COMMITTEE ON SMALL BUSINESS
SUBCOMMITTEE ON ENERGY,
ENVIRONMENT, SAFETY, AND RESEARCH

MIGRATORY BIRD
CONSERVATION COMMISSION

BOARD OF REGENTS
SMITHSONIAN INSTITUTION

Congress of the United States
House of Representatives
Washington, D.C. 20515

DISTRICT OFFICES:
FEDERAL BUILDING
78 CENTER STREET ANNEX
PITTSFIELD, MASSACHUSETTS 01201
PHONE: 413-442-0946

280 HIGH STREET
CENTURY PLAZA II
HOLYOKE, MASSACHUSETTS 01040
PHONE: 413-532-7510

January 11, 1982

Mr. John Chapoton
Assistant Secretary for Tax Policy
United States Department of the Treasury
3120 Treasury Building
Washington, D.C. 20220

Dear Mr. Chapoton:

I am writing to you on the subject of industrial revenue bonds, specifically the enforcement of IRS Ruling 81-216 governing tax treatment of certain types of industrial revenue bonds. As you are aware, Public Law 97-92, making further continuing appropriations for the fiscal year 1982, contains a section dealing with IRS Ruling 81-216 and proposed amendments to certain sections of the Income Tax Regulations.

As the sponsor of the substitute resolution which cleared the Congress, and was ultimately signed by the President, I would like to have, as soon as possible, your official interpretation of the intent of the section dealing with tax treatment of industrial revenue bonds, and a detailed statement of how the language in this section is being administered.

With best wishes, I am

Cordially yours,

[S]

Silvio O. Conte
Member of Congress

SOC:db

SILVIO O. CONTE
FIRST DISTRICT, MASSACHUSETTS

COMMITTEE ON APPROPRIATIONS
RANKING MINORITY MEMBER
SUBCOMMITTEES:
TRANSPORTATION
LABOR-HEW
LEGISLATIVE
EX OFFICIO MEMBER
OF ALL SUBCOMMITTEES

COMMITTEE ON SMALL BUSINESS
SUBCOMMITTEE ON ENERGY,
ENVIRONMENT, SAFETY, AND RESEARCH

MIGRATORY BIRD
CONSERVATION COMMISSION

BOARD OF REGENTS
SMITHSONIAN INSTITUTION

Congress of the United States
House of Representatives
Washington, D.C. 20515

February 11, 1982

WASHINGTON ADDRESS:
2300 RAYBURN OFFICE BUILDING
WASHINGTON, D.C. 20515
PHONE: 202-225-5335

DISTRICT OFFICES:
FEDERAL BUILDING
78 CENTER STREET ANNEX
PITTSFIELD, MASSACHUSETTS 01201
PHONE: 413-442-0946

200 HIGH STREET
CENTURY PLAZA II
HOLYOKE, MASSACHUSETTS 01040
PHONE: 413-535-7810

Mr. John Chapoton
Assistant Secretary for Tax Policy
United States Department of the Treasury
3120 Treasury Building
Washington, D.C. 20220

Dear Mr. Chapoton:

On January 11th, I wrote to you on the subject of tax treatment of certain industrial revenue bonds as reflected in IRS Ruling 81-216. To date, I have not received a reply to that letter.

As I mentioned in my January 11th letter, Public Law 97-92, making further continuing appropriations for Fiscal Year 1982, contained a section dealing with IRS Ruling 81-216. For your information, I have attached a copy of my earlier letter.

The purpose of this letter is to advise you that I would like to have, in the near future, a reply to the January 11th letter outlining your official interpretation of the intent of the section dealing with the tax treatment of industrial revenue bonds, and a detailed statement of how the language in this section is being administered. I will look forward to a prompt reply.

With best wishes, I am

Cordially yours,

Silvio O. Conte
Member of Congress

SOC:db

EXHIBIT 2.—SBA APPORTIONMENT DOCUMENT FROM OMB

STANDARD FORM 132
(Revised July 1976)
Office of Management and Budget
Circular No. A-34

Sheet 1 of 1
Fiscal year 1982

APPORTIONMENT AND REAPPORTIONMENT SCHEDULE

AGENCY: SMALL BUSINESS ADMINISTRATION
BUREAU:
APPROPRIATION OR FUND TITLE AND SYMBOL: 73X4141 Pollution Control Equipment Contract Revolving Fund

DESCRIPTION	AMOUNT ON LATEST S.F. 132	AGENCY REQUEST	ACTION BY OMB
BUDGETARY RESOURCES			
1. Budget authority:			
A. Appropriations realized			
B. Appropriations anticipated (indefinite)			
C. Other new authority ( )			
D. Net transfers (+ or −)			
2. Unobligated balance:			
A. Brought forward October 1 Actual	35,096,000	35,008,090	
B. Net transfers (+ or −)			
3. Reimbursements and other income:			
A. Earned thru October		55,539	a)
B. Change in unfilled customers' orders (+ or −)			
C. Anticipated for rest of year	29,000,000	24,744,461	a)
4. Recoveries of prior year obligations:			
A. Actual			
B. Anticipated for rest of year			
5. Portion not available pursuant to P.L. (−)			
6. Restorations (+) and writeoffs (−)			
7. TOTAL BUDGETARY RESOURCES	64,096,000	59,808,090	59,808,090
APPLICATION OF BUDGETARY RESOURCES			
8. Apportioned: (Memorandum: Obligations incurred)			
Category A:			
(1) First quarter	420,000	b)	420,000 b/
(2) Second quarter			360,000 b/
(3) Third quarter ( )	2,080,000		360,000 b/
(4) Fourth quarter ( )			360,000 b/
Category B:			
(1)			
(2)			
(3)			
(4)			
9. Withheld pending rescission			
10. Deferred			
11. Unapportioned balance of revolving fund	61,596,000	59,808,090	58,308,090
12. TOTAL BUDGETARY RESOURCES	64,096,000	59,808,090	59,808,090

SUBMITTED: [signature] 12/14/81
(Authorized officer) (Date)
Harry S. Carver, Controller

APPORTIONED: Joyce J. Walker DEC 31 1981
(Date)
Joyce J. Walker
Deputy Associate Director
Transportation, Commerce
and Housing

a) Guarantee fee 21,300,000
Application fees 300,000
Investment income 3,200,000
24,800,000

b) Authorized Program Levels (SBA Share in Thousands of Dollars) represents

Quarter	SBA Request	OMB Action	Loss Reserve
1	42,000	42,000	420
2	70,000	36,000	360
3	70,000	36,000	360
4	68,000	36,000	360
TOTAL	250,000	150,000	1,500

No losses are anticipated for this program.

NOTE: After the 1st quarter, no repayments of contracts or loans financed from the proceeds of tax exempt bonds will be guaranteed by this account.

EXHIBIT 3.—APPROPRIATIONS COMMITTEE REJECTION OF BUDGET PROPOSAL

NEAL SMITH
MEMBER OF CONGRESS
FOURTH DISTRICT, IOWA

WASHINGTON OFFICE:
2373 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, D.C. 20515
PHONE: (202) 225-1426

DISTRICT OFFICE:
344 INSURANCE EXCHANGE BUILDING
DES MOINES, IOWA 50309
PHONE: (515) 284-4634

Congress of the United States
House of Representatives
Washington, D.C. 20515

February 11, 1982

CHAIRMAN
APPROPRIATIONS SUBCOMMITTEE FOR:
DEPARTMENT OF COMMERCE
DEPARTMENT OF JUSTICE
DEPARTMENT OF STATE
FEDERAL JUDICIARY
SMALL BUSINESS ADMINISTRATION
FEDERAL TRADE COMMISSION
F.B.I.
S.E.C.
F.C.C.
INTERNATIONAL TRADE COMMISSION
U.S. TRADE REPRESENTATIVE
U.S. ARMS CONTROL AGENCY
UNITED NATIONS AGENCIES
MEMBER
APPROPRIATIONS SUBCOMMITTEE FOR:
DEPARTMENT OF HEALTH AND HUMAN SERVICES
DEPARTMENT OF LABOR
DEPARTMENT OF TRANSPORTATION
N.L.R.B.
R.R. RETIREMENT BOARD
NATIONAL INSTITUTES OF HEALTH
SOCIAL SECURITY
PUBLIC HEALTH SERVICE
MISCELLANEOUS RELATED AGENCIES
MEMBER
COMMITTEE ON SMALL BUSINESS

Mr. Donald Templeman
Acting Administrator
Small Business Administration
Washington, D. C. 20416

Dear Mr. Templeman:

This refers to the letter of January 29 from Mr. Cardenas indicating that the Small Business Administration has decided to reduce the Pollution Control Equipment Guarantees program to a level of $150 million for FY 1982 and to eliminate funds for tax exempt bonds after December 31, 1981.

The Committee hereby disapproves this proposal and strongly urges you to make available the full authorization of $250,000,000 for the Pollution Control Equipment Guarantees program, as contained in Public Law 97-35, the Omnibus Budget Reconciliation Act of 1981. Demand for this guarantee program continues to be very strong. Your proposed action could have an extremely detrimental effect on the ability of many small businesses to obtain the necessary funds to comply with state and local pollution control requirements. In addition, as Mr. Cardenas noted in his letter, this program has not sustained any losses since its inception and has thus made money for the Federal Government through the fees charged. Therefore, we believe that this program has been proven to be an efficient means of meeting the needs of the small business community while at the same time protecting the interests of the taxpayer. We expect you to make available the full level authorized for the program for FY 1982 by the Congress.

With best wishes.

Sincerely,

/s/

Neal Smith, Chairman
Subcommittee on Commerce,
Justice, and State, the
Judiciary and Related
Agencies

U.S. GOVERNMENT
SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

January 29, 1982

Honorable Neal Smith
Chairman, Subcommittee on the
Departments of Commerce, Justice,
State, the Judiciary, and Related Agencies
Committee on Appropriations
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

The Pollution Control Equipment Contract Guarantees program level for FY 1982 has been reviewed with respect to its consistency with the Administration's credit control policies. Within the context of the Economic Recovery Program and its efforts to reduce the amount of Federal credit involvement in the marketplace, we feel that this program should be reduced to a level of $150 million and that no funds be authorized for tax-exempt bonds after December 31, 1981, rather than the $250 million contained in the Committee's report.

As a group, small businesses will benefit more from the Administration's efforts to stabilize financial markets, reduce interest rates, eliminate regulations and lower inflation than the very small percentage of clients assisted through this program. In addition, the revised program level of $150 million represents a 50 percent increase over FY 1981 actual program level of $100 million. An increase of a greater magnitude could create deficiencies in the delivery of a program that has not sustained any losses since its inception.

Therefore, in accordance with requirements contained in the Committee's report, I am notifying you of this action. Also, proposed credit limitation language for FY 1982 reflecting this level will be transmitted with the President's FY 1983 Budget Request.

Sincerely

(Signed) Michael Cardenas

Michael Cardenas
Administrator

APPENDIX B.—CORRESPONDENCE BETWEEN CHAIRMAN BEDELL AND DAVID STOCKMAN, DIRECTOR OF THE OFFICE OF MANAGEMENT AND BUDGET

United States House of Representatives
Committee on Small Business
Subcommittee on Energy, Environment, and
Safety Issues Affecting Small Business
B-363 Rayburn House Office Building
Washington, D.C. 20515

February 24, 1982

Hon. David Stockman, Director
Office of Management & Budget
17th & Pennsylvania, N.W.
Washington, D.C., 20503

Dear David:

This is to provide written confirmation of recent telephone conversations between this Subcommittee's staff and Mr. Fred Upton in OMB's legislative liaison office.

The House Small Business Committee's Subcommittee on Energy, Environment and Safety will be holding a hearing on Wednesday morning, March 10, as part of our continuing oversight of the Small Business Administration's pollution control loan guarantee program. We would like to have a representative of the Office of Management and Budget present to testify on policy decisions affecting the SBA program.

Last November, the Subcommittee held a similar hearing. All of the witnesses we heard from the private sector and from various state governments were unanimous in their support for this program. Moreover, the witnesses from the Small Business Administration told us that the program was well-run, had never experienced a loss in its five-year history, actually had produced over $15 million in revenue for the government, and had a number of new applicants seeking to enter the program.

Despite all this, we were told that the Office of Management and Budget had instructed the SBA to limit FY 82 program activity to a $95 million level where no new loan guarantee commitments could be made, and new applicants essentially were being turned away. This occurred in spite of the fact that Congress had, only a few months before, raised the program's ceiling to $250 million.

Moreover, the week after our hearing, we were advised that OMB had lowered the pollution control loan guarantee program's annual commitment authority to $50 million -- a level that would have had the effect of closing the program to new applicants for almost two years. Congress responded to this almost immediately, by including a provision for a $175 million minimum program activity level in the continuing resolutions.

Now, we are informed that OMB has told the SBA that they can issue $150 million in loan guarantees, but that none of this authority can be used to back tax-exempt issues, such as revenue bonds. This restriction, of course, is directly contrary to the stated intent and letter of the law establishing the pollution

control loan guarantee authority.

It is quite obvious to the Subcommittee, both from the statements of witnesses at our previous hearing, and from our own direct observations, that key policy decisions regarding this program are not being made by officials at the Small Business Administration. Quite clearly, the decisions affecting this program, and the people it is intended to serve, are being made within the Office of Management and Budget. Consequently, we ask that a representative of the OMB appear as a witness at our hearing on March 10.

The hearing will begin at 9:00 a.m. and should be adjourned by noon. We will meet in Room 2359 of the Rayburn House Office Building.

We ask that all witnesses provide 50 copies of any prepared statements. At least 10 copies should be delivered to the Subcommittee's office not later than the day before the hearing. If you have any questions concerning this hearing, please contact our staff director, Marc Rosenberg, at 225-8944.

Sincerely,

BERKLEY BEDELL
Chairman

BB/mhr
cc: Hon. Silvio Conte

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

The Honorable Berkley Bedell
Committee on Small Business
B-363 Rayburn
Washington, D.C. 20515

Dear Berkley:

I regret that I am not able to appear before the House Small Business Committee's Subcommittee on Energy, Environment, and Safety. I did want to respond, however, to your letter of Feb. 24, 1982 concerning an important issue to be considered by the Committee, the pollution control loan guarantee program.

As you indicated in your letter, a decision has been made to permit the guarantee of $150 million in pollution control loan or contract repayments during 1982. This decision, which results in a 1982 program level that is 50% higher than the 1981 actual level, was made with two caveats:

--- First, that in view of the President's efforts to constrain Federal borrowing, the increase in guarantee authority for the pollution control program would be offset by a comparable reduction in other SBA credit programs.

--- Second, that in view of the Administration's opposition to Federal guarantees of tax-exempt bonds, the guarantees of repayments would be limited to loans or contracts that are financed from the proceeds of taxable bonds.

With respect to your allegation that this decision constitutes a violation of the law, I must strongly disagree. The Second Continuing Resolution for Fiscal 1982 (P.L. 97-92) did not "lock in" a $250 million program level for this Fund. In fact, the resolution did not provide statutory credit limitations for any of the SBA loan programs.

Federal guarantees for tax-exempt bonds would deny revenue to the U.S. Government while primarily benefiting high-income purchasers of the bonds rather than small businesses. In addition, such a Federal guarantee would add to the pressures on the municipal bond market by creating a security that is superior to all other tax-exempt securities issued by State and local governments. This could result in higher borrowing costs for State and local governments, which must finance schools, roads, hospitals, and other essential public facilities.

The Administration is continuing its efforts to alleviate Federal regulatory burdens that contribute to the high cost of operating small businesses. Where such regulations are necessary, we are attempting to ensure small business access to capital to comply with such requirements.

It is my understanding that Treasury Department officials may wish to testify further on this subject should you call additional hearings that focus on tax-exempt bonds.

Sincerely,

David A. Stockman

DAVID A. STOCKMAN
Director

APPENDIX C.—LETTER FROM PETERSON, DIEHL AND COMPANY, NEWPORT BEACH, CALIFORNIA

PETERSON, DIEHL AND COMPANY
INVESTMENT BANKERS
1201 DOVE STREET - SUITE 570
NEWPORT BEACH, CALIFORNIA 92660
TELEPHONE (714) 955-2000

TELEX 65-6311
CABLE: INVESTBANK

March 5, 1982

Honorable Berkley Bedell, M. C.
Chairman
Subcommittee on Energy, Environment & Safety
House Committee on Small Business
Room B363 RHOB
Washington, D. C. 20515

Dear Mr. Bedell:

Thank you for the opportunity to submit these comments to your hearing on March 10, concerning the use of tax-exempt financing used in connection with pollution control financing guarantees issued by The Small Business Administration.

My business career of almost 25 years has been devoted almost totally to the financing of capital projects for small and medium size businesses. Our firm's investment banking activities all focus on this area.

I have had a personal involvement with tax-exempt pollution control financing since its enactment in 1968. From 1975 to 1978, I was the Executive Secretary of the Californania Pollution Control Financing Authority, where I developed procedures and mechanics for use of this guarantee, and supervised the pilot program in California.

EXPERIENCE

This program is an outstanding example of fulfilling a critical need for long term financing for small businesses. Its principal function is to provide well managed smaller business enterprises with equal access to the long term credit markets enjoyed by major corporations. Its purpose is being extremely well demonstrated and this, as a financing tool, is exemplary for other programs.

The experience has been better than we had predicted when structuring the risk analysis and projections for the program in the early 1970's. Almost 10% of the loans guaranteed would have to default to exhaust the SBA's reserve or capital funds for these guarantees. In my view, this has shown to be a practical way that we might provide genuine support for these businesses, much like residental mortgages were provided with loan guarantee support in the early 1960's. That technique has proven to be an excellent and accepted practice.

If this program is allowed to continue to expand and used as a demonstration, it appears very probable that, at some future point, like the residental mortgage loan insurance business, private parties will join in with SBA and eventually this technique could become common. In the meantime, it is essential that this continuity be preserved.

It cannot be overemphasized that this is a means by which small businesses can gain access to the long term capital markets on a similar basis as large companies. As long as the major large firms and utilities have the availability and use of tax-exempt financing for pollution control, small businesses should enjoy the same privilege.

There is a grave inconsistency and illogic if small businesses are being denied access to a credit market which major companies continue to have.

DEMAND

There is an absolute and continuing demand for pollution control facilities by small businesses. In many respects, the relative pressures are greater on them than on large companies.

Local environmental quality agencies are putting greater pressures and burdens on businesses to keep toxic and hazardous materials out of their sewer systems and the air. In California, for example, about sixty percent of the volume of toxic materials entering the sewer systems emanates from generators who are small businesses. If you look at the composition of two major industries, electronics and automotive (where electroplating plays an important role), you will see them populated by and large by major firms who are in the assembly and distribution business, and thousands of small firms which do the manufacturing and processing which give rise to the discharge of hazardous and toxic materials.

These toxic materials have been considered solely as air and water pollutants. In the last few years as they have begun to be removed from the environment, they have taken on a new dimension as we recognize their harmful effects. Not only are the environmental quality pressures building on these businesses, but also they are faced with the potential for civil and other liabilities which causes them to maintain their pace of investment in these facilities. They remain nonproductive and have a much weightier drag on the capital structure of these companies because, in many cases, such investments equal to half or more of the total capital investment of the business.

There may be a current lull in the demand of these financings. There are two reasons. First, the general economy, and particularly the automotive and electronics industries, has reduced the demand for services of these companies. Thus they have reduced capital investments. Second, reconsideration being given to the impacts of our environmental quality regulations. It seems very doubtful that they are going to evaporate.

In my estimation, simplifying the regulations will make enforcement more effective than before, so that these businesses have a better understanding of the needed standards, and there will be less room for non-compliance. The onus of enforcement is going to fall on the local air and water quality and waste-disposal agencies, who will be hard pressed to resist the concerns of the local community for maintaining environmental quality.

The SBA cannot claim it has knowledge of the demand for the guarantees. In 1981, we proposed that the SBA make a study or investigation of the potential capital requirements for small businesses to meet environmental standards. This proposal was encouraged and reviewed, but in the end, was turned down. I do not see how the SBA can speak with any authority when they have no information about demands for pollution control facilities among small businesses.

We, have strong reason to believe that there is a demand that far outstrips the authorization that has been provided to the SBA for this program. My estimate is that the demand may annually exceed $300,000,000 with the current level of economic activity and environmental quality requirements, and could go as high as $500,000,000 annually with the resumption of economic improvement. This could be calculated as a finite amount, given achievement of environmental quality standards, and we see companies change their processes with less wastes and toxic by-products.

FINANCIAL MARKETS

Without the access to the tax-exempt bond markets, the investment banker must turn to other sources. The Treasury claims that we should use sources that will create tax revenues from the interest.

This may not be all that easy. The purchasers of government guaranteed securities are institutions, and generally are pension funds or other security-minded purchasers with little or no tax obligations. These are the markets that we would have to turn to.

Our other alternative in an effort to find economical interest rates on these securities is the foreign market. We do find an interest among foreign purchasers in these types of government-guaranteed securities, because of some of the unique features of the pollution control guarantees.

In all these instances, we can assert that the purchasers of the bonds secured with these guarantees would not be taxable by the U.S. Treasury and therefore the Treasury would not suffer a gain on tax revenues through their use. In fact, the Treasury probably would suffer an increased revenue loss because the interest cost and deductions by the small businesses would increase, reducing their taxable income, while the investor's income remains untaxable.

The Treasury should recognize the important equation that exists in tax-exempt pollution control bonds, more so than any other type of security. On one side, the reduced interest costs to a business using this technique would normally increase its taxable income, thereby giving the Treasury the additional tax revenues that it would not have otherwise. On the other side of the equation, in so far as purchasers of tax-exempt securities are concerned, they are going to find tax-shelters, whether in pollution control bonds, real estate, equipment leases and other types of tax-advantaged investments.

We also believe that the tax-exempt pollution control bond for small businesses is also purchased by some investors in the interest of the public purpose as much as anything else. There is a recognition that assisting small businesses in meeting environmental quality standards can be among the highest social priorities and therefore tips the balance in making a decision among tax advantaged investments equal in other respects.

Finally, as the Treasury so aptly says, this is a security of the highest quality, and probably is superior to obligations of the U.S. Treasury itself. If that is the case, then there is ample recognition that this must be an excellent and most effective means of providing assistance to small business. As we all know, these businesses provide jobs for over 80% of the non-government sector, and has the problems and needs which this committee is dedicated to helping to alleviate. I know of no program that is more effective and less of a burden to the U.S. Treasury or tax payer in accomplishing its function.

If the Treasury does maintain its posture that it is innappropriate that the SBA's credit underlie these tax-exempt bonds, it seems fair to suggest that it should be consistent in other areas. Take, for example, the recent $825,000,000 sale of tax-exempt bonds by Washington Public Power Supply System for nuclear plants which were wholly secured by power purchase contracts with the Bonneville Power Administration. Or, issues of the Commonwealth of Puerto Rico secured with other forms of government contracts, or of local governments in Tennesse, Alabama and Kentucky, where TVA is involved.

I appreciate the opportunity to submit my comments to you, and will be glad to answer any questions.

Yours very truly,

PETERSON, DIEHL & COMPANY

James H. McCall

James H. McCall
Director of Project Finance

JHM/pb

cc: Hon David Drier, M.C.
Senator Alan Cranston
Senator S. I. Hayakawa

APPENDIX D.—LETTER FROM KUTAK, ROCK, AND HUIE, WASHINGTON, D.C.

KUTAK ROCK & HUIE
A PARTNERSHIP
INCLUDING PROFESSIONAL CORPORATIONS
1101 CONNECTICUT AVENUE, N. W.
WASHINGTON, D. C. 20036
(202) 828-2400

March 30, 1982

Mr. Marc H. Rosenberg, Staff Director
House Subcommittee on Energy,
Environment and Safety Issues
Affecting Small Business
B-363 Rayburn House Office
Building
Washington, D.C. 20515

Dear Mr. Rosenberg:

This letter is in response to your inquiry regarding the costs associated with the issuance of tax-exempt industrial development bonds as compared to those incurred in a taxable corporate debt offering.

For the sake of comparison, we outline the costs of issuance of a $10,000,000 industrial development revenue bond and a $10,000,000 registered corporate debt offering to the public. While $10,000,000 may appear to be a high figure to select for an initial public offering by a small company, it is economically unfeasible to publicly offer a smaller amount of taxable debt because the issuance costs other than the underwriter's discount are largely fixed and constitute too great a percentage of the borrowing.

The issuance costs described below are typically amortized over the life of the bond issue which, in the case of industrial development revenue bonds will generally be in the 20 to 30 year range while taxable debt typically matures within 12 to 20 years of issuance.

	industrial development bonds	corporate debt offering
Preparation of legal documents	$ 10,000	$ 20,000
Preparation of description of company and transaction	15,000	40,000
Determination of validity of bond issue and tax exempt status of interest	1,000	-0-
SEC Registration Fee	-0-	2,000
NASD filing fee	-0-	100

	Industrial development bonds	corporate debt offering
Accountant's fee	$ 2,500	$ 15,000
Trustee's fee	2,500	2,500
Issuer's counsel fee	1,000	-0-
Printing cost for offering document	7,500	30,000
Bond printing costs	2,500	2,500
State securities law research and filing fees	2,500	20,000
Underwriter's discount	250,000	350,000
Total	$294,500	$482,100
Percentage of issue	2.9%	4.8%

These estimates are competitive with the existing market as we know it. It is our understanding that other firms offering comparable services would provide comparable estimates.

Sincerely,

Haven N.B. Pell

APPENDIX E.—LETTER FROM HON. JAMES A. RHODES, GOVERNOR, STATE OF OHIO

JAMES A. RHODES
GOVERNOR

STATE OF OHIO
OFFICE OF THE GOVERNOR
COLUMBUS 43215

March 9, 1982

Rep. Berkley Bedell
Chairman
House Subcommittee on Energy, Environment,
and Safety Issues Affecting Small Business
United States House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

On behalf of the people of Ohio, I call upon your subcommittee and the Congress as a whole to take whatever steps are necessary to reinstate a small but vital federal loan guarantee program that is being destroyed by an arbitrary decision of the Office of Management and Budget.

That program is the one by which the Small Business Administration has guaranteed tax-exempt financing for pollution control facilities. OMB has, by pure executive fiat, ordered that SBA not guarantee any pollution financing except on taxable issues.

The SBA program has been extraordinarily effective in helping small businesses throughout the country to meet federally mandated pollution control at no cost to the federal government. The program has usually entailed the sale of SBA guaranteed bonds which are free from federal income taxation. In Ohio, nineteen companies, employing 1,498 people, have had their pollution control bond issues guaranteed in the total amount of $36,470,000. We believe that many of these businesses would not have been able to finance their compliance with pollution laws in the normal financial markets. The impact on those companies - and employees - from violating those laws could have been tragic.

But that was just the beginning. Twenty-six more Ohio companies, employing 2,127 people, already have been issued inducement resolutions to finance an additional $46,060,000 of pollution control. OMB's policy shift has put their projects in a deep freeze and their futures in jeopardy. And we know of at least sixty to eighty more small businesses in Ohio, employing from 3,000 to 4,000 people, who are in varying stages of the SBA application process. Without SBA guaranteed tax-free financing, these companies, and many others who don't know yet that they have pollution compliance problems, won't be able to finance mandated compliance.

Ohio will find itself in the unpalatable position of having to enforce federal pollution laws against Ohio businesses who are violating those laws because of federal policy changes which destroyed their ability to comply. That is bad government!

We hope that you will be able to convince the few individuals in the administration who have decreed this arbitrary change to reverse themselves. But if that does not occur, we ask that you promptly develop legislation to require that the SBA continue to guarantee tax-free pollution control financing at the levels previously recommended by Congress.

Yours very truly,

JAMES A. RHODES
Governor

JAR/mls

APPENDIX F.—LETTER FROM HON. WILLIAM G. MILLIKEN, GOVERNOR STATE OF MICHIGAN

STATE OF MICHIGAN

LANSING

WILLIAM G. MILLIKEN
GOVERNOR

March 18, 1982

The Honorable Berkley Bedell, Chairman
Subcommittee on Energy, Environment and
Safety Issues Affecting Small Business
House Committee on Small Business
Room B-363
Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Bedell:

Thank you for providing this opportunity to express our views on an important subject.

The availability of reasonable financing for Michigan small businesses facing costly non income producing pollution control investments is critical for the economic recovery and continuing strength of the Michigan economy.

I support the Small Business Administration Pollution Control Financing Program for small businesses for these reasons:

1. Financing should be available to small business on the same terms available to large businesses. This SBA program through the guarantee and resulting pooling allows small business to access the tax-exempt market on the same basis as large business. This financing is critical to the survival of many small businesses.

2. The government is requiring that costly pollution control equipment be installed by businesses. This investment represents a large capital commitment in non-productive equipment by small businesses. In most cases, it represents a critical decision whether that small business should make the commitment or go out of business. The commitment usually represents a doubling of the fixed assets for the company.

3. The Small Business Administration Pollution Control Financing Program's level of guarantees only represents a small portion of the total Federal government guarantees. (At the $250,000,000 level, it would be .0014 percent).

4. By not allowing the Small Business Administration guarantees to be used with tax-exempt bonds, it effectively eliminates the capital cost savings. The higher interest rate on the bonds, plus the bond issuance costs effectively raise the cost of the money. Those companies that could carry that level of debt will not use the program and those companies that cannot carry the higher debt will be turned down by the Small Business Administration. In addition, the buyers of taxable bonds, if any are issued, will often be those entities which do not pay income tax, such as pension funds and foundations. Thus very little new federal revenues are generated by using taxable bonds.

5. Because of its good track record and the premium charged, the program has no direct cost to the Federal government. In fact, because the projects financed allow the companies to continue in business, these companies retain existing jobs and often generate new jobs. This results in income taxes being collected instead of more unemployed people and the associated costs of unemployment compensation and public welfare.

The results to date of the program in Michigan include the retention of 1,908 jobs for thirty-five Michigan companies. In addition, there are 1,940 employees involved in thirty-four pending projects awaiting action.

I urge you to take the necessary action to assure the continuation of the program.

Sincerely,

William G. Milliken

Governor

APPENDIX G.—COMMENTS BY FRANK S. SWAIN, SBA CHIEF COUNSEL FOR ADVOCACY, RE: REVENUE RULING 81–216

11 DEC 1981

Honorable Roscoe L. Egger, Jr.
Commissioner of Internal Revenue
Internal Revenue Service
1111 Constitution Avenue, N. W.
Washington, D. C. 20224

Dear Commissioner Egger:

This letter is submitted with respect to the Notice of Proposed Rulemaking published by your agency in the Federal Register on October 8, 1981, and containing proposed regulations relating to the term "issue" for purposes of Section 103(b) of the Internal Revenue Code of 1954, as amended.

The Office of Advocacy was established as a separate office within the Small Business Administration (SBA) by Public Law 94-305. Part of the duties of the Office are contained in Section 203 of the aforementioned statute. Paragraph (4) of that Section states that the Chief Counsel shall "represent the views and interests of small businesses before other Federal agencies whose policies and activities may affect small business." The whole issue of industrial revenue bonds is of great interest to small business, and therefore we wish to comment on the proposed regulation on behalf of small business.

On August 24, 1981, your agency issued Rev. Rul. 81-216 which set forth the tests it would use to determine whether multiple lots of $1 million each of industrial development bonds would qualify as separate exempt small issues or would be treated as a single large issue not qualifying for the $1 million small issue exemption. Under the ruling, multiple lots of bonds of $1 million will be treated as a single large issue not qualifying for exemption under Section 103(b)(6)(A) of the Internal Revenue Code if 1) the obligations will be sold at substantially the same time, 2) the obligations will be sold under a common plan of marketing, 3) the obligations will be sold at substantially the same rate of interest, and 4) a common or pooled security will be either used or available to pay debt service on the obligations. This revenue ruling revoked three earlier rulings on the subject which allowed multiple lots to qualify as separate exempt small issues and thereby reversed a longstanding position of the Internal Revenue Service (IRS). The proposed regulations, which are the subject of this document, reflect the position taken by your agency in Rev. Rul. 81-216.

We believe that the proposed regulations would substantially impair an important mechanism which enables small businesses to raise badly needed capital in the states and localities affected. As clearly indicated by most recent trends and information, high interest rates have been and will continue driving small businesses from traditional sources of credit. In many cases, financing is not available at any price.

Certain states and localities, recognizing the importance of a strong local economy based on job creating small businesses have been trying to assist by making tax-exempt financing available to small businesses in certain circumstances. These programs have been very effective in providing small businesses with a vital source of capital often not otherwise available and at interest rates below prevailing commercial interest rates. By pooling or "bundling" together a number of small issue bonds of less than $1 million, and thereby combining the legal expenses and underwriting fees, the public entities involved in these activities have been able, through the cost efficiencies of this marketing method, to provide access for small businesses to a financing mechanism previously available all too often only to large corporations. Furthermore, at the time of the ruling, several additional states were contemplating the adoption of such programs.

The effect of Rev. Rul. 81-216 and the proposed regulations incorporating and superceding it is to prevent "bundling," thereby effectively eliminating the programs described above because of the costs involved. In essence, the position taken in the ruling and proposed regulations makes it economically less feasible for states to raise low cost capital with programs targeted to small business. If the programs can be restored under the constraints of the proposed regulations, a doubtful proposition, it will necessarily be on a substantially smaller scale combined with greater costs and more limited marketing potential.

We believe it to be grossly inequitable for the IRS to reverse its longstanding position enunciated in a series of private and published revenue rulings without a full and adequate explanation of the policy revisions for such a radical change. The simple statement in Rev. Rul. 81-216 that prior rulings did not consider the factors described in the Rev. Rul. 81-216 is a woefully inadequate basis for a policy reversal which impacts so heavily on small business. States and localities have established and funded programs in reliance on the overturned series of rulings, which were reasonable interpretations of the term "issue." Others were about to announce such programs or were seriously considering them. In addition, small businesses with access to such programs have come to view this vehicle as a viable source of financing. In view of this reliance, we do not believe there should be a sudden and complete reversal of position by administrative fiat without a full review of the economic impact of such a change. In view of the circumstances in which this action was taken, the IRS reversal is the equivalent of legislation rather than an exercise of the interpretative role of its administrative function.

If the concern of the IRS in taking this action is with the use of small issue industrial development bonds by large corporations or with what it considers to be inappropriate uses of the funds from such bonds, we share its concern. In this light, we can understand why the IRS could consider multiple lots or issues for the benefit of one company as one issue, as it does in example 17 of the proposed regulations. However, we do not understand why these legitimate concerns warrant effectively closing down programs where the multiple issues are each for the benefit of separate companies.

We believe that the broad approach taken by the proposed regulations unfairly impacts most heavily upon the small businesses which are intended to be the primary beneficiaries of small issue industrial development bonds. Thus, in order to deal with abuses by large companies and in the use of funds, the proposed regulations eliminate those state and local programs which rely on "bundling" to achieve the economies of scale necessary to successfully issue the separate lots of bonds. In so doing, the proposed regulations effectively eliminate, as described above, a crucial avenue for small businesses to obtain access to industrial revenue bond financing and therefore access to needed capital and credit which otherwise may not be available to them. This is entirely too severe a remedy and contravenes the basic purposes of the small issue industrial revenue bond provisions. In essence the IRS is targeting the industrial revenue bond mechanism away from that part of the economy that needs it the most.

In any event, we believe, as indicated above, that the question is only one element of broader policy questions involved which should be considered in the context of a general discussion of the entire industrial revenue bond area. A more appropriate forum for this discussion is the Congress and not the administrative process. The Office of Advocacy supports the elimination of abuses in the industrial revenue bond process and supports a basic debate on how and whether to target such financing to small businesses and to specific uses which contribute to economic growth and development. We are surprised the IRS would undertake this administrative action given the general review that is underway. We strongly urge the IRS to postpone issuance of final regulations and rescind Rev. Rul. 81-216 pending completion of this general policy review.

We would be pleased to discuss with you our comments on this specific issue as well as the general policy questions involved in the industrial revenue bond area. If you have any questions concerning our comments or wish to discuss any aspects of the industrial revenue bond question please call me or Robert L. Bolle, our tax counsel, at 653-6169.

Yours truly,

/s/

Frank S. Swain
Chief Counsel for Advocacy

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